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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

CAROL HARLEY, *et al.*,

Petitioners,

v.

3M COMPANY, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Retired employees of 3M Company (formerly known as Minnesota Mining & Manufacturing Co.) who are participants in its defined benefit pension plan claim that plan fiduciaries violated their strict ERISA duties by making and maintaining an imprudent and prohibited investment in Granite Corp., a new, speculative hedge fund that invested in collateralized mortgage obligations. Granite collapsed in March 1994, resulting in the total loss of the plan's investment. When measured in 1998, the cumulative investment loss to the plan was approximately $80 million. Despite substantial record evidence that the fiduciaries breached their duties, the Court of Appeals for the Eighth Circuit, in a 2-1 decision, ruled that the statute could not be read to confer standing on the participants to pursue ERISA remedies to restore the investment loss because of the temporary emergence during the pendency of the case of a supposed plan "surplus." The court also ruled that there could be no ERISA prohibited transaction violation when the investment manager for Granite inflated the valuations of plan assets on which its compensation was based so long as the rate of compensation appeared to be reasonable.

The questions presented are:

(1) *Whether, contrary to the decisions of three other Circuits, Congress' express grant of standing to participants to police the conduct of their pension plan fiduciaries and to seek remedies to restore investment losses to their plan must be nullified in order to avoid supposed Article III standing problems when a fiduciary violation does not result in immediate financial injury to the participants themselves but the large loss to their plan remains unredressed?*

(2) *Whether, contrary to the decisions of another Circuit and every other federal court that has considered the question, and the longstanding interpretation of the statute expressed in the Department of Labor regulation, the ERISA prohibited transaction rules against fiduciary self-dealing are subject to an exemption when a plan investment manager inflates the valuation of assets that are the basis for the fees it pays itself?*

LIST OF PARTIES

Petitioners (also referred to herein as "the participants") are former employees of 3M Company, formerly known as Minnesota Mining & Manufacturing Company, who are vested participants in its ERISA-governed, defined benefit pension plan, the Employee Retirement Income Plan ("the Plan"). The named plaintiffs-appellants in the two consolidated cases below who are petitioners here are Carol Harley, Lenora Banaszewski, and Michael Payton, suing individually and on behalf of a certified class of Plan participants.

Defendants-appellees below, all of whom are respondents here and Plan fiduciaries, are 3M Company, Guilio Agostini, Michael J. Barrett, Larry E. Eaton, Harry A. Hammerly, Richard A. Lidstad, Dwight A. Peterson, and John J. Ursu.

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The opinion of the Court of Appeals for the Eighth Circuit, dated March 26, 2002, is reported at 284 F.3d 901, 27 EBC 2089 (CA8 2002), and is reproduced in the attached Appendix at 1a-17a. The July 11, 2002 order of the Court of Appeals denying the participants' petition for rehearing and rehearing *en banc* appears in the Appendix at 80a. The two opinions of the U.S. District Court for the District of Minnesota which were reviewed by the Court of Appeals in the first of the two consolidated appeals, docketed at 8th Cir. No. 00-2214, are the March 31, 1999 opinion reported at 42 F. Supp.2d 898 (D. Minn. 1999), and the March 29, 2000 unreported opinion. These opinions are reproduced in the Appendix at 40a-79a and 20a-39a, respectively.

In petitioners' later-filed companion case against the individual fiduciary respondents, the District Court issued another dismissal ruling, an unreported decision dated December 7, 2000, based on the collateral estoppel effect of its March 1999 and March 2000 rulings. The December 2000 ruling was the subject of the second of the two consolidated appeals, docketed at 8th Cir. No. 01-1213. The Court of Appeals affirmed the dismissal ruling based on its disposition of the issues raised in the first appeal. (15a-16a).

JURISDICTION

The judgment of the Court of Appeals was entered March 26, 2002. Appendix at 18a-19a. Petitioners timely sought rehearing and rehearing *en banc*. Their petition for rehearing was denied by order dated July 11, 2002. Appendix at 80a. This Court's jurisdiction is based upon 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The relevant provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended, are §§ 406(a)-(b), 408(b)-(c), 409(a), and 502(a), 29 U.S.C. §§ 1106(a)-(b), 1108(b)-(c), 1109(a), and 1132(a). The texts of these provisions are reproduced in the attached Appendix at 81a-92a.

STATEMENT OF THE CASE

This case, involving undisputed large losses to a pension plan due to apparent fiduciary imprudence, raises critical questions about the enforcement of ERISA's strict fiduciary duties and prohibited transaction rules. The divided opinion of the Eighth Circuit creates conflicts among the Circuits on two questions. First, the decision conflicts with and departs from the understanding of ERISA and constitutional requirements held by three other Circuits (the Second, Fourth and Ninth) on the question of plan participants' standing to enforce ERISA's substantive duties and obtain relief when their plan suffers losses due to fiduciary wrongdoing. According to these courts, ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2), expressly authorizes participants to sue on behalf of their plan to restore plan losses, and the invasion of participants' statutory interests in prudent management of their plan is sufficient to satisfy Article III standing requirements. Congress thus acted within its constitutional powers in adopting traditional trust law enforcement rules and granting participants tools and authority to police their plan fiduciaries. Contrary to these three Circuits, the Eighth Circuit's decision impermissibly tampers with the enforcement structure so carefully framed by Congress. Indeed, the lower court's new construction of the statute effectively holds that Congress was forbidden to grant concurrent enforcement authority to participants who could demonstrate the loss to their plan but not immediate financial injury to themselves. Finally, the decision makes participant standing depend on factual circumstances that are not related to the violation and the loss to the plan. The Eighth Circuit's standing analysis rests on undefined standards to measure supposed plan "surplus," the ever-changing vagaries of financial markets, and speculation about long-term performance of a plan over future decades.

Second, the Eighth Circuit's decision conflicts with the decisions of the Ninth Circuit and every other federal court that has considered the question whether fiduciary self-dealing is exempted from ERISA prohibited transaction rules. In this case,

the evidence showed that the plan's investment manager could inflate the valuation of assets on which its fees were based, thus impermissibly setting the amount of its own compensation. Contrary to the decision of every other court and the longstanding Department of Labor regulation, the Eighth Circuit ruled that a limited statutory exemption which allows persons to serve a plan in multiple capacities, ERISA § 408(c)(2), 29 U.S.C. § 1108(c)(2), is a broad license for fiduciaries to self-deal with respect to their own compensation.

As demonstrated by the participation below of both the Secretary of Labor and the Pension Benefit Guaranty Corporation in support of the participants, these are questions of great concern to effective enforcement of the ERISA statute.

A. Statement of the Facts

Petitioners and the other members of the class they represent are current and former 3M employees who are participants in its defined benefit pension plan, the Employee Retirement Income Plan ("the Plan"). Petitioners themselves are retired employees who currently receive retirement benefits from the Plan. Plan investments are overseen by the Plan fiduciaries, who include all of the respondents.

1. Facts Relating to the Imprudent Investment in Granite Corporation

Beginning in September 1990, respondents, acting as Plan fiduciaries, decided to make and thereafter maintain an investment of $20 million in Granite Corp., a new, speculative hedge fund that invested in thinly traded, illiquid collateralized mortgage obligations ("CMOs"). Granite collapsed in March 1994, resulting in the total loss of the Plan's investment, then valued at over $33 million. When measured in the spring of 1998, the cumulative investment loss to the Plan was approximately $80 million. *See* 1999 D. Ct. Mem. at 9, 48a.

The Court of Appeals' opinion does not refer to the record evidence which supported the claim of fiduciary imprudence. This evidence was detailed in the District Court's March 1999

opinion (41a-47a). The court summarized it as follows in denying 3M's initial motion for summary judgment on this claim:

> The Class has offered evidence that many staff and PAC [Pension Asset Committee] members mistakenly thought Granite was a low-risk investment, did not understand the risks associated with CMOs and the CMO market, did not know that Granite was highly leveraged, did not know that Granite's managers lacked experience with CMOs, were not aware of potential illiquidity problems, were not able to appreciate the nature of Granite's strategy, and did not realize or understand the changes over time in Granite's leverage and hedge position. Moreover, the differences between the risk disclosures in the marketing materials and the PPMs [Private Placement Memoranda], Granite's change in investment managers, and the structure of [the investment manager's] compensation, all were factors about which 3M decision makers should have known and deliberated. Had the staff and PAC undertaken adequate investigation, deliberation, and monitoring activities, they all would have learned of these risks and other circumstances, and factored them into the decision of whether to make or maintain the investment. A fact finder could conclude that a reasonably prudent fiduciary, armed with all of this information, would have determined that the Granite investment contained significant risks and unknown dangers, and therefore was improvident.

1999 D.Ct. Mem. at 21-22, 61a-62a.

2. Facts Relating to the Prohibited Transaction Presented by the Granite Investment

The record also showed the following facts supporting the participants' claim that respondents caused the Plan to engage in an ERISA prohibited transaction.

Respondents caused the Plan to agree to pay Granite's investment manager, which also was a Plan fiduciary, performance-based "incentive" fees equal to 15% of any increase in the value of the Granite portfolio in excess of LIBOR. The larger the return that the manager reported for the Plan, the larger were the fees that it could deduct from the Plan assets under its management. During the life of the investment, the Plan paid accrued incentive fees totaling $1,168,756.

The Private Placement Memoranda (PPMs) for Granite expressly warned that the values for the CMOs were not being set by independent sources but instead were determined by Granite's directors or by Granite's manager asking CMO dealers for prices. There were several other clear disclosures that the CMOs were not being valued independently. In 1991, 1992, and 1993, Plan staff received Granite's audited financial reports which stated that the CMOs did not have readily available market quotations and that these securities instead were being valued by Granite's directors. The latter two reports also disclosed that none of the securities held by Granite had generally available valuations.

The record also showed that Granite's investment manager was negotiating valuations of assets and thereby exploited its fiduciary authority over Plan assets to increase its incentive fees. This self-dealing by Granite's investment manager was well summarized by the Plan's chief investment officer, who admitted that "there really was only a theoretical price" for the CMOs "because no real market existed," and Granite's manager and the brokers "would negotiate a price."

The Plan's chief investment officer also admitted knowing that the periodic pricing of Granite's securities could be a

"game," and that when dealer valuations were "out of line" Granite's manager could "convince the dealers" of that. Reports by the investment manager also confirmed that it negotiated values for Granite's CMO securities. For example, Granite's August 1991 monthly letter to investors, the first authored by David Askin for the new incoming manager, stated that one of his first tasks was "to get the dealers to establish more consistent marks for the securities which we own." In order to place a value on the investments owned by Granite (for the purpose of computing asset values and investor returns), he persuaded dealers to give him higher quotes.

This negotiation of values for the securities held by Granite was also confirmed by the allegations made by the Plan and other Granite investors in their pending suit in the Southern District of New York suit against the manager, Askin Capital Management, and a number of CMO broker-dealers. *See* Op. at 3, n.4, 3a, n.4. In authorizing the Plan's participation as a plaintiff in that suit, respondents adopted allegations that the manager and the brokers had a "symbiotic relationship," and that the brokers "aided [the investment manager] in its campaign to charge inflated prices and report inflated results to the Investors." *See* Complaint, *ABF Capital Mgmt. v. Askin Capital Mgmt.*, No. 96-CV-2978 (S.D.N.Y.) (filed in N.Y. Supreme Court March 27, 1996, removed April 24, 1996) at ¶¶ 52, 60-61, 67, 121-30. The complaint alleged that

> [t]o make its monthly valuation reports to Investors as favorable as possible, [the investment manager] would frequently "negotiate" with the Brokers to improve the marks over the original marks they provided. . . . These inflated and false marks were then used by [the investment manager] to create reports that were sent to the Investors and that [the investment manager] knew (or recklessly or negligently failed to know) were materially false and misleading and overstated the actual values of the Investors' investments.

B. District Court Proceedings.

The District Court's jurisdiction over the federal questions presented by the cases was based upon 28 U.S.C. § 1331. The participants filed their initial class complaint on June 10, 1996 and an amended complaint in December 1996. (2000 D.Ct. Mem. at 3 n. 1, 22a n. 1). In September 1997, the District Court certified the case as a class action under Fed. Rule Civ. Proc. 23(b)(1)(B) and 23(b)(2), with the class consisting of all Plan participants and beneficiaries.

Following completion of discovery in 1998, the court entertained cross-motions for summary judgment. The participants moved for partial summary judgment on the ground that 3M's fiduciary violation was established insofar as it had caused the Plan to enter into compensation arrangements with Granite's manager that posed a conflict of interest and prohibited transaction. 3M cross-moved for summary judgment on all of the participants' claims, asserting various legal and factual deficiencies. It also moved to dismiss or for summary judgment on their claim relating to the Granite compensation arrangements.

By opinion dated March 31, 1999, 40a-79a, the District Court ruled on the pending motions. The court denied the participants' motion for partial summary judgment and instead granted 3M's cross-motion for summary judgment, ruling that the compensation arrangements for Granite were exempted from prohibited transaction rules by ERISA § 408(c)(2), 29 U.S.C. § 1108(c)(2), and that the participants could not establish that Granite's compensation was unreasonable, that being deemed the only possible basis for liability under this theory. 1999 D.Ct. Mem. at 22-27, 62a-67a. With respect to 3M's motion for partial summary judgment, the court denied the motion, finding that the record presented substantial evidence and triable issues of 3M's imprudent conduct in violation of its ERISA fiduciary duties. 1999 D.Ct. Mem. at 2-22, 41a-62a. However, based on the newly-issued decision in *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999), which had not been briefed by the parties,

the court ruled that 3M would have a basis to avoid liability due to the Plan's funding level, *i.e.*, if the Plan had a "surplus" there would be no loss to the Plan and hence no actionable violation. 1999 D.Ct. Mem. at 29-34, 68a-73a. Because the record did not contain sufficient evidence on the Plan's funding level, the court denied 3M's motion for summary judgment but invited the parties to conduct further discovery and file renewed motions for summary judgment. 1999 D.Ct. Mem. at 33-34, 74a-75a.

Following additional discovery directed to the most recent valuation of plan funding, *i.e.*, a valuation as of January 1, 1999, in October 1999 3M filed a second motion for summary judgment, limited to the question of whether the plan had a "surplus." The motion and plaintiffs' opposition were supported by opinions of actuarial experts.

By opinion dated March 29, 2000, 20a-39a, the District Court granted 3M's renewed motion for summary judgment and dismissed the case. The court found and 3M did not dispute, *see* 29a-30a, 36a-37a, that the Plan was not 100% funded under valuations performed in conformity with either ERISA's mandated "termination basis" methodology, *see* 29 U.S.C. §§ 1058, 1344; 29 C.F.R. §§ 4044.41-75, or "RPA 94 [Retirement Protection Act of 1994] current liability" methodology, *see* 29 U.S.C. § 1082(d). The court nevertheless determined that it was sufficient if the Plan was funded to at least 90% of RPA 94 current liability in order for the court to conclude that it was so adequately funded that no actionable investment loss had occurred. The District Court adhered to the principle announced in its March 1999 opinion and ruled that because there was a "surplus" under its criteria there was no actionable violation. March 2000 D.Ct. Mem. at 17-18, 37a-38a. Judgment was entered for 3M on March 29, 2000.

The participants appealed to the Eighth Circuit (appeal docketed at 8th Cir. No. 00-2214).[1]

C. Eighth Circuit Proceedings.

The jurisdiction of the Court of Appeals for the Eighth Circuit was based on 28 U.S.C. § 1291. The Court of Appeals consolidated the participants' two appeals and rendered its decision on March 26, 2002, in an opinion authored by Judge Loken and joined in for all purposes by Judge Murphy. Judge Bye authored a separate opinion concurring in the portion of the decision dealing with the prohibited transaction claim, but dissenting from the panel majority's ruling that the participants did not have standing to pursue their claim to restore the losses to the Plan caused by the fiduciaries' alleged imprudence. (Op. at 13-14, 16a-17a).

First, the panel majority ruled that the provision of ERISA expressly authorizing plan participants to seek relief for fiduciary violations causing losses to their plan, § 502(a)(2), 29 U.S.C. § 1132(a)(2), must be read as denying authorization to sue in the circumstances of this case, where a "robust, richly-funded, ongoing plan" appeared to have a "surplus." The majority rejected the District Court's premise that there had been no loss to the Plan, acknowledging that the claimed violation had caused losses of tens of millions of dollars and "reduced the pool of Plan assets." (Op. at 6, 7a). However, the majority agreed with

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1. The District Court's March 1999 opinion stated that its "no actionable loss" rule "appears to apply only to fiduciaries that are employers." 1999 D.Ct. Mem. at 32 n. 23, 73a. In September 1999 the participants filed a second action against the remaining respondents, individuals who were additional fiduciaries responsible for the Granite investment. The action was stayed pending resolution of the case against 3M. On December 7, 2000, on motion for summary judgment by the individual respondents, the District Court dismissed the second case based on collateral estoppel, ruling that dismissal was dictated by its previous conclusion of no actionable loss due to the level of Plan funding. The participants' appeal was docketed at 8th Cir. No. 01-1214.

the District Court that if this loss only reduced the amount of Plan surplus then it "has not caused [plaintiffs] . . . any cognizable harm" and was "a loss only to 3M, the Plan's sponsor." (Op. at 6, 8a). The majority believed that its construction of the statute to deny standing to participants in these circumstances was necessary to avoid "serious Article III case or controversy concerns." Accordingly, "if the Plan's surplus was sufficiently large that the Granite investment loss did not cause actual injury to plaintiffs' interests in the Plan," then the participants could not enforce ERISA's fiduciary provisions and secure monetary and injunctive relief on behalf of their Plan. (Op. at 7-9, 8a-10a). The majority also affirmed the District Court's factual basis for its conclusion "that the Plan's surplus is adequate" – the temporary emergence, during the pendency of the case, of a supposed plan "surplus" calculated using optimistic, non-statutory measures of funding. The majority ruled that the two methods specified in the statute for calculating plan funding, which showed that the Plan was not fully funded, were not relevant to determination of surplus in an ongoing plan. (Op. at 9-10, 11a-12a.).

Judge Bye dissented from this ruling on the fiduciary breach claim. He believed that the majority was not free to construe § 502(a)(2) to avoid supposed standing problems, because under *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 142 n.9, 144 (1985), that provision "only permits participants or beneficiaries to bring suit *in a representative capacity* to remedy injury to the Plan itself" and not on their own behalf. (Op. at 13, 16a). Addressing the standing question, Judge Bye concluded that the participants "satisfy the case-or-controversy requirements of Article III by standing in the shoes of a party that clearly has standing – the Plan itself." As statutorily designated agents of the Plan, the participants could bring suit "because the Plan's injuries suffice to confer Article III standing." (Op. at 13-14, 16a-17a.)

In the second part of its decision, the Eighth Circuit unanimously affirmed the summary judgment ruling dismissing

the participants' ERISA prohibited transaction claim on the ground that the categorical ban on fiduciary self-dealing with plan assets does not apply where a fiduciary manipulates asset valuations to increase the compensation it receives if the resulting compensation appears to be reasonable (Op. at 10-11, 13a-14a). The court ruled that ERISA's categorical prohibition of fiduciary self-dealing was "sensibly" negated by a statutory exemption, ERISA § 408(c)(2), 29 U.S.C. § 1108(c)(2), reproduced at 88a-89a, that allows fiduciaries to "receiv[e]" "reasonable compensation" where they render multiple services to a plan or plan sponsor. The court believed that the participants had not rebutted the fiduciaries' factual showing that the compensation paid to the Granite manager was "reasonable" and that the claim therefore was properly dismissed. (Op. at 10-11, 13a-14a).

The participants' petition for rehearing and rehearing *en banc* of both rulings was denied by Order dated July 11, 2002 (80a). Three judges of the court, Judges McMillian, Bye and Riley, would have granted the petition for rehearing *en banc*. Two other judges took no part in considering the petition.

The petition for rehearing was supported by both the Secretary, U.S. Department of Labor (who also had supported the participants and urged reversal at the merits briefing stage and had participated in oral argument), and the Pension Benefit Guaranty Corporation, appearing as *amici curiae*. Petitioners accordingly suggest that the Court should invite the Solicitor General to file a brief expressing the views of the United States on the questions presented by this Petition.

REASONS FOR GRANTING THE PETITION

I. THE DECISION BELOW CONFLICTS WITH DECISIONS OF THREE OTHER CIRCUITS HOLDING THAT ERISA PERMISSIBLY AUTHORIZES PLAN PARTICIPANTS TO SEEK REMEDIES FOR INVESTMENT LOSSES SUFFERED BY THEIR OWN PLAN AS A RESULT OF FIDUCIARY VIOLATIONS. THE DECISION BELOW ALSO CONSTITUTES AN IMPERMISSIBLE JUDICIAL ALTERATION OF CONGRESS' CAREFULLY DESIGNED ENFORCEMENT STRUCTURE.

The Court should review this case to resolve the conflict among the Circuits on the question whether ERISA's express statutory grant to plan participants of authority and standing to sue to police the conduct of their plan fiduciaries presents any question of constitutional infirmity based on the standing requirement of Article III, § 2 of the Constitution, or whether there is any other justification for altering the statute's carefully designed enforcement structure in this and similar cases. The Circuits are split on this question. Until the ruling below, no court had ever questioned the centuries-old trust law principle that participants/beneficiaries can sue to enforce compliance by their fiduciaries with strict fiduciary standards. Nor had there ever been any judicial disagreement that Congress permissibly, and wisely, had adopted this rule for ERISA plans in order to vest concurrent fiduciary enforcement authority in the individuals who had the best opportunity to detect wrongdoing and the greatest interest in safeguarding the financial integrity of their plans. Congress legislated and imposed strict standards to protect plan assets for all plans and for all market conditions. It did not invite courts to tamper with its carefully framed enforcement structure based upon their evaluations of temporary market trends or their hopes that large investment losses ultimately might not be of consequence to plan participants over decades to come.

A. The Decision Below Conflicts With Decisions of Three Other Circuits Holding that Participants Unquestionably Have Standing to Enforce Fiduciary Standards, Even in Situations Where a Plan Currently Appears to Have a Surplus, and that the Statute's Substantive Standards are Not Linked to the Supposed Funding Level of a Plan.

The holding of the Court of Appeals majority, that a plan's supposed current "surplus" or "robust" status precludes participant enforcement of fiduciary standards, contravenes ERISA's unqualified command that breaching fiduciaries "*shall* be personally liable to make good to [the affected] plan *any* losses to the plan resulting from [their] breach." ERISA § 409(a), 29 U.S.C. § 1109(a) (emphasis added). It also invalidates Congress' express direction that plan participants, the Secretary of Labor, and plan fiduciaries are each empowered to enforce fiduciary standards and obtain this relief for a plan. *See* ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) (action for relief under § 409 may be brought "(2) by the Secretary, or by a participant, beneficiary or fiduciary").

As a result of its departure from the statute, the ruling by the Eighth Circuit majority squarely conflicts with decisions by every other court that has considered the standing of participants to enforce fiduciary standards in connection with defined benefit pension plans, including decisions from three other Circuits.

The Second Circuit, in *Financial Inst. Ret. Fund v. Office of Thrift Supervision*, 964 F.2d 142 (CA2 1992), resolved a dispute over the allocation of surplus assets held by a multiemployer pension fund. Plan participants intervened in the suit, alleging that the allocation by plan officials violated their fiduciary duties. The Second Circuit first considered the question of "a participant's standing to sue for breaches of fiduciary duty under ERISA." 964 F.2d at 144. The fundamental principle which guided its analysis was that:

> Although Congress may not dispense with the dictates of Article III, *see Warth [v. Seldin]*, 422 U.S. [490,] 501 [(1975)], "[t]he actual or threatened injury required by Art. III may exist solely by virtue of 'statutes creating legal rights, the invasion of which creates standing.'" *Id.* at 500 (quoting *Linda R.S. v. Richard D.*, 410 U.S. 614, 617 n. 3 (1973)); *see also Joint Anti-Fascist Refugee Comm. v. McGrath*, 341 U.S. 123, 152 (1951) (Frankfurter, J., concurring) ("standing may be based on an interest created by the Constitution or a statute").

Id. at 147 (parallel citations omitted). Noting that ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2), "empowers beneficiaries to bring a civil action to redress *any* violation of the statute's fiduciary requirements," the court rejected the District Court's conclusion, *see Financial Inst. Retirement Fund v. Office of Thrift Supervision*, 766 F. Supp. 1302, 1309 (S.D.N.Y. 1991), that the participants lacked standing because they would receive all benefits to which they were entitled and the risk to plan assets resulting from the allocation was speculative and remote. *Id.* at 148. The Second Circuit ruled that, inasmuch as the allocation of surplus assets was an act of plan administration governed by ERISA fiduciary duties, and the fiduciaries' alleged conflict of interest in making the allocation of surplus would injure the participants' statutory interest in fiduciary compliance, the participants had standing under Article III. *Id.* at 149. "This broad view of participant standing under ERISA is further supported by ERISA's goal of deterring fiduciary misdeeds." *Id.* The same analysis led to a conclusion of standing in *Olsen v. Hegarty*, 180 F. Supp.2d 552, 562-64 (D.N.J. 2001).

The Ninth Circuit likewise concluded that participants satisfied standing rules in *Amalgamated Clothing & Textile Workers Union v. Murdock*, 861 F.2d 1406 (CA9 1988). The suit concerned a defined benefit pension plan which had been terminated, with the participants receiving payment of all benefits to which they were entitled. However, the participants

claimed that before the termination, plan fiduciaries had misused plan assets to further their own interests, in the process earning substantial profits. The plan provided that upon termination, any surplus assets could revert to the plan sponsor, ownership of which was controlled by one of the fiduciary defendants charged with the violation. *Id.* at 1408-09. The Court of Appeals examined standing in the context of the ERISA statutory scheme. It determined that, as under the common law of trusts, the rule of fiduciary liability even where the violation did not cause any impairment of participant benefits was consistent with the goals of ERISA. "[W]hether beneficiaries have been financially damaged by the breach is immaterial." *Id.* at 1412, *citing* G. Bogert & G. Bogert, *The Law of Trusts and Trustees* § 543 at 217 (2d ed. 1978). Thus, the participants had standing to seek redress, whether the ill-gotten profits were returned to the plan or distributed to them in order to avoid any return of the profits to the wrongdoing fiduciary. *Id.* at 1415.

A third conflicting decision, by the Fourth Circuit, also upheld the principle of participant standing to sue to enforce ERISA fiduciary standards for plan mismanagement and demonstrates that this principle is one of long standing. In *Brink v. Dalesio*, 667 F.2d 420 (CA4 1981), the court stated without qualification:

> [S]tanding has never been denied to a participant in and beneficiary of a fund who, moreover, seeks to recover funds for the plan rather than for himself. To deny standing to one in such circumstances who seeks such relief would, in our view, contravene the very language of § 1132(a)(2).

Id. at 427.[2] Although the court thus reversed a decision

2. These conflicting Circuit decisions are not altered, and the panel majority's contrary ruling is not supported, by *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999). *See* Op. at 5-6, 6a-8a. Neither fiduciary investment duties, violations, nor remedies were discussed in that case. The case instead involved a participant challenge to plan amendments (Cont'd)

denying standing to an intervening plaintiff who was a participant in a health and welfare plan, its reasoning was not limited to that type of plan. The key point for the Fourth Circuit was that the participant was seeking "recovery for the fund of which he was a beneficiary for the benefit of all participants and beneficiaries." *Id.* at 427.

The Eighth Circuit reached the opposite conclusion without discussing these contrary decisions. Under the conflicting authority from these three Circuits, however, the funding status of a plan has no bearing on the liability of plan fiduciaries who violate ERISA's duties and cause losses to a plan, or on the standing and statutory authorization of participants to sue to restore the losses.

B. The Eighth Circuit Majority Created a Conflicting New Rule of Standing that Interferes with Congress' Carefully Framed ERISA Enforcement Structure.

The decision below conflicts with these Circuit decisions because the panel majority impermissibly rewrote the statute based on its own notions of how best to implement ERISA fiduciary standards in pension plans. Despite the undisputed large loss to the Plan and the substantial evidence of the fiduciaries' imprudence, the majority created a new enforcement rule that excised the word "participant" from § 502(a)(2) and the phrases "*shall* be personally liable" and "to make good . . . *any* losses to the plan resulting from [the] breach" from § 409(a).

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improving benefits for other participants. The Court rejected the claim, reasoning that the amendments were proper under the employer's "broad authority to amend a plan" and that even if the amendments reduced an alleged plan surplus, the participants had "no entitlement to share in" any surplus *personally* and could not complain that these *unimpaired* plan assets instead were being used to fund new benefits. 525 U.S. at 439-41. Here, in contrast, the participants are not making any personal claim to Plan assets or challenging their use. The participants instead seek to restore undisputed Plan losses for the benefit of the Plan as a whole.

This re-engineering of ERISA based on judicial views of what is best for plans and participants is "unsuitable for courts [and one] would expect a clear mandate before inferring that Congress meant to foist it on the judiciary." *Geissal v. Moore Medical Corp.*, 524 U.S. 74, 87 (1998).

It is particularly impermissible to alter ERISA's careful enforcement structure based on supposition about plans that temporarily experience a supposed "surplus" at some point during the pendency of a case. In an ongoing plan, "surplus" cannot even be determined. *See Shepley v. New Coleman Holdings, Inc.*, 174 F.3d 65, 70-71 (CA2 1999) ("the fact of a surplus or deficit, and its amount, can only be determined by hindsight" "the fact of overpayment can only be determined upon termination of the Plan"). As the Seventh Circuit stated in an analogous setting, involving withdrawal liability in a multi-employer plan,

> [I]t is extraordinarily hard to know what is necessary to adequately fund the pension plan and simultaneously do equity to the participants. . . . Congress has not seen fit to provide such a rule [to avoid supposed "overpayment"], and especially considering the uncertainties involved, it is impermissible to provide one by judicial fiat.

Central States, Southeast and Southwest Areas Pension Fund v. Nitehawk Express, Inc., 223 F.3d 483, 495 (CA7 2000).

As the three conflicting Circuit decisions hold, Congress properly designated participants to act as plan representatives in all circumstances of fiduciary violations. "[T]he crucible of congressional concern was misuse and mismanagement of plan assets by plan administrators." *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. at 140 n.8. In § 409 in particular, Congress was "primarily concerned . . . with remedies that would protect the entire plan, rather than with the rights of an individual beneficiary." *Id.* at 142. Participant suits for relief under § 409(a) for investment losses therefore are suits *on behalf of the plan.*

See id. at 142 n.9, 144 (wording of § 502(a)(2) "indicative of Congress' intent that actions for breach of fiduciary duty be brought in a representative capacity on behalf of the plan as a whole"; relief runs only to plan). A plan itself is not a party authorized in § 502(a)(2) to sue for fiduciary violations, and it often may be under the control of the errant fiduciaries themselves.

Congress also enacted strict standards of conduct to protect plans and their participants, including the fiduciary duties to act "solely in the interest of the participants and beneficiaries" and to act with prudence and care. § 404(a)(1), 29 U.S.C. § 1104(a)(1). The participants are the only parties to whom these fiduciary duties are owed and are the primary occupants of the statute's "zone of interests." Congress thus adopted traditional common law trust doctrine, where it has long been the rule that "No one except a beneficiary or one suing on his behalf can maintain a suit against the trustee to enforce the trust or to enjoin or obtain redress for a breach of trust." Restatement (Second) of Trusts § 200 (1959). The panel majority, however, mistakenly believed that there was no "violation of duty" to the participants and hence no actionable claim by them. (Op. at 8, 10a).

As the three conflicting Circuit decisions recognize, but the Eighth Circuit majority did not, courts should be "reluctant to tamper with an enforcement scheme crafted with such evident care as the one in ERISA." *Russell*, 473 U.S. at 147.[3]

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3. As this Court explained in *Russell*, ERISA's enforcement mechanism was carefully framed and limits the parties who can sue for relief under § 409(a). The panel majority nevertheless concluded that, even if participants could not sue in this case, then at least the Secretary of Labor and "any party with a reversionary interest in the plan's surplus" could do so. Op. at 10 n. 5, 12a. But a party "with a reversionary interest" is not owed fiduciary duties and is not among the parties who are authorized to sue in § 502(a)(2). This is not surprising. The ultimate existence of a surplus on plan termination and a reversion, its year of occurrence, and the identity of the party having any reversionary interest, are all contingent facts that ordinarily would not be knowable at the

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C. As the Conflicting Decisions Hold, ERISA Permissibly Provides that Plan Participants Have Standing to Enforce Fiduciary Duties.

Although the Eighth Circuit majority purported to construe the statute to avoid constitutional questions (Op. at 7, 8a), it effectively held that the statute as written (and as interpreted by this Court in *Russell*) is unconstitutional because Congress was forbidden to grant participants the right to police and protect their own plan in circumstances where they could not demonstrate immediate financial injury to themselves rather than to their plan.

As the conflicting Circuit decisions recognize, however, the participants present a justiciable "case or controversy" involving a specific violation, by specific defendants, causing an identifiable large financial loss to the Plan, which § 409(a) directs "shall" be restored. Where a dispute is otherwise justiciable, "the question whether the litigant is a 'proper party to request adjudication of a particular issue' . . . is one within the power of Congress to determine." *Sierra Club v. Morton*, 405 U.S. 727, 732 n.3 (1972). Congress did this in § 502(a)(2).

Consistent with this congressional judgment and the long history of such actions under the law of trusts, the participants clearly have sufficient interest in the claim and standing under

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time of a fiduciary breach and a suit to redress it. The panel majority did not attempt to reconcile these points with its rule that participants in the injured plan itself, who are among the parties Congress *did* authorize to sue, are barred from suit.

The panel majority also did not explain why, if the Plan is deserving of statutory protection and relief, the loss should be actionable only by the Secretary of Labor and not by the Plan's own participants. Like the participants, the Secretary has not personally suffered any immediate financial injury, its interests in the matter are created by statute, and the supposed funding level of the Plan is the same. In addition, the Secretary's enforcement resources are limited, a factor which makes the statute's concurrent participant enforcement so essential.

the tripartite test of *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) ("invasion of a legally protected interest," "a causal connection between the injury and the conduct complained of," and a likelihood that "the injury will be 'redressed by a favorable decision'").

First, the participants' legally protected interests have been invaded. The Granite loss has impaired the security of their retirement benefits and diminished the Plan's ability to pay all promised benefits and provide future improved benefits such as post-retirement cost-of-living increases. "If the fiduciary breach reduced the plan's assets by $80 million, as alleged by the plaintiffs, then the participants' benefits are less secure." Secretary of Labor Amicus Br. in Support of Pet. for Rehearing 3 (May 23, 2002). In addition to these economic harms, ERISA creates enforceable interests for participants in the financial integrity of their plans and their fiduciaries' compliance with ERISA standards. The invasion of these statutory interests likewise creates injury sufficient for standing purposes. "Congress may create a statutory right or entitlement the alleged deprivation of which can confer standing to sue even where the plaintiff would have suffered no judicially cognizable injury in the absence of the statute." *Warth v. Seldin*, 422 U.S. 490, 514 (1975), *citing Linda R. S. v. Richard D.*, 410 U.S. 614, 617 n.3 (1973). Even if participants' statutory interests were not regarded as economic, they still suffice to establish standing.[4]

Second, there is no dispute that the invasion of the participants' and the Plan's interests were caused by the

4. The panel majority's standing analysis also ignores the established principle that an actionable ERISA violation does not require financial loss. Even in its absence, a participant can sue under § 409(a) for "other equitable or remedial relief" to ensure compliance with fiduciary and prohibited transaction rules. *See, e.g., Leigh v. Engle*, 727 F.2d 113, 122 (CA7 1984). In this respect, the majority impermissibly "raise[d] the standing hurdle higher than the necessary showing for success on the merits in an action alleging noncompliance" with the statute. *Friends of the Earth, Inc. v. Laidlaw Environmental Services, Inc.*, 528 U.S. 167, 181 (2000).

respondent fiduciaries' imprudent investment in Granite and the resulting large loss to the Plan. Third, the relief requested will redress the violation. The participants and the Plan will benefit from relief in at least the following ways: (1) tens of millions of dollars will be restored to the Plan, improving its financial soundness and ability to pay all promised retirement benefits as well as improved benefits; (2) "other equitable or remedial relief" will correct the fiduciaries' investment practices and prevent and deter future breaches of duty; and (3) Plan management will be strengthened. These forms of relief "remedy the injury."

Congress therefore acted well within its constitutional power in designating participants to serve as litigation representatives or agents for their plans. As Judge Bye concluded in dissent (Op. at 14, 17a), "the plaintiffs' suit certainly satisfies the 'statutory' zone of interests tests when the statute itself authorizes plan beneficiaries to act for the Plan in a representative capacity." The participants are not the hypothetical but inapposite "stranger[s] to the plan" discussed by the majority (Op. at 7, 14, 9a, 17a).

Assuming that participant standing could be justified solely as a matter of their "representational standing" (by ignoring the invasion of their own interests), Congress' decision to make them litigation representatives of their plans is a policy judgment that is not constrained by the Constitution. "'[T]he general prohibition on a litigant's raising another person's legal rights' is a 'judicially self-imposed limi[t] on the exercise of federal jurisdiction,' not a constitutional mandate." *United Food and Comm'l Workers Union Local 751 v. Brown Group, Inc.*, 517 U.S. 544, 557 (1996). Representational standing "rests on the premise that in certain circumstances, particular relationships (recognized either by common-law tradition or by statute) are sufficient to rebut the background presumption (in the statutory context, about Congress's intent) that litigants may not assert the rights of absent third parties." *Id.* When Congress so authorizes one party to sue to prosecute the interests of another,

"the only impediment to that suit" is the judicially fashioned, "prudential" limitation and "there is no question that Congress may abrogate the impediment." *Id.* at 558. In ERISA § 502(a)(2), Congress did exactly this – it incorporated common law trust remedies based upon the relationship between a trust/plan and its beneficiaries/participants. In this representational setting, a plan's "injury in fact suffices to confer standing" on participants who sue on its behalf. *Vermont Agency of Natural Resources v. U. S. ex rel. Stevens*, 529 U.S. 765, 774 (2000).

There are no more vigorous protectors of the interests of a pension plan than its own participants who depend on it as the source of their retirement security. As three conflicting Circuit decisions hold, participants' status as stakeholders creates a clear interest in the financial soundness of their plan and their fiduciaries' compliance with ERISA duties. Congress properly designated them as representatives who can obtain relief for their plan. "This congressional determination warrants judicial attention and respect." *Friends of the Earth, Inc. v. Laidlaw Environmental Services, Inc.*, 528 U.S. 167, 185 (2000).

D. The Eighth Circuit's Conflicting Ruling Spawns Undesirable Problems For Courts and Litigants in Cases Involving Pension Plans.

The Court of Appeals' ruling also creates new and undesirable problems for litigants and courts and interferes with effective enforcement of the statute as it relates to pension plans. The panel majority's rule makes standing depend on uncertain predictions about current and long-term funding status for a plan. Funding calculations rest on assumptions about long-term asset performance, benefit accruals, mortality, retirement ages, future employer behavior, and the like. For a funding calculation ultimately to prove accurate, overall experience over future decades must match or exceed the assumptions. As stated by the Pension Benefit Guaranty Corporation in urging rehearing below, "The presence of a temporary surplus at the time of a breach says almost nothing about whether the Plan will be fully

funded five, ten, twenty, or more years in the future." PBGC Amicus Br. Supporting Pet. For Rehearing 10 (May 23, 2002).[5]

Standing thus becomes a matter of speculation. The majority's ruling, moreover, impermissibly gives a breaching fiduciary the full benefit of that speculation. It is an established precept of ERISA and trust law that in cases of investment losses caused by fiduciary breaches, "Courts do not take kindly to arguments by fiduciaries who have breached their obligations that, if they had not done this, everything would have been the same." *In re Beck Indus., Inc.*, 605 F.2d 624, 636 (CA2 1979). But the decision below would allow breaching fiduciaries to avoid liability based on speculation that a plan's funding status years from now would be the same with or without the breach.

The majority's standing rule also has no apparent limits. Under the logic of the rule, funding status would mean no injury and no standing even in cases of reckless or intentional violations of either the general fiduciary duties of ERISA § 404, the prohibited transaction rules of § 406, or the anti-inurement rule of § 403(c)(1). Thus, as an example, prohibited transactions could be immunized so long as a plan appeared to have a "surplus" at some point during the litigation. If this were not the consequence of the majority's standing rule, and prohibited transaction claims could be pursued even in the circumstance of supposed full funding (as the majority seemed to determine by proceeding to consider, without discussion of this issue, the merits of the prohibited transaction claim), then one must divine some rationale to distinguish one form of fiduciary wrongdoing from another and to justify different treatment of claims brought under the same statutory enforcement provisions. But no such rationale or principled distinction is apparent.

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5. The majority's underlying supposition of a temporary plan "surplus" also was incorrect. As stated by the Pension Benefit Guaranty Corporation, "At no relevant time did the Plan have a surplus under ERISA; the record establishes just the opposite." PBGC Amicus Br. Supporting Pet. For Rehearing 5 (May 23, 2002).

The majority's standing rule makes standing and liability hinge on ever-changing variables. If funding levels are the criterion of standing and redress for a fiduciary violation, then § 409's categorical command that a breaching fiduciary "shall . . . make good . . . any losses" to the plan will depend on the happenstance of when plan funding is measured and the most recent performance of financial markets. But today's financial prediction is no assurance of long-term future performance or full plan funding. Indeed, this case is an unfortunate but graphic illustration of the problem. The lower courts here ruled on the basis of Plan valuations measured as of January 1, 1999 – a date near the peak of the 1990's market bubble. The information now available (limited to public sources, due to the unavailability of discovery during the appeal process and respondents' refusal to turn over current valuations) shows that the Plan is underfunded, even under optimistic, non-statutory methodologies.[6]

Finally, the lower court's linking of participant standing to the supposed level of plan funding relies upon an undefined standard for determining the existence of "surplus." This approach indicates that participant standing would not exist to redress violations even in *underfunded* but so-called "robust, richly-funded" plans, Op. at 10, 12a, or in many plans generally,

6. The District Court ruled on the basis of Plan funding that was measured at the height of the 1990's bull market. The market has declined considerably since then. In 3M's most recent FAS 87 valuation, which utilizes assumptions that are more optimistic than those mandated by the statute, the Plan appeared to be underfunded by approximately $ 300 million as of September 30, 2001. *See* 3M's 2001 SEC 10-K Report, Notes to Consolidated Financial Statements, at 55-56 (showing underfunding of $ 500 million in all U.S. defined benefit plans, including $ 196 million for another unfunded non-qualified pension plan) (filing available at *www.sec.gov/edgar*). The phenomenon of "vanishing pension surplus" is widespread. *See, e.g.*, "The New Pinch from Pensions," *Business Week*, August 5, 2002 at 44-46 (quoting 3M's CFO as acknowledging Plan underfunding in article published three weeks after rehearing was denied).

because fiduciary violations often do not cause immediate financial injury to participants. This consequence underscores that the Eighth Circuit's standing rule has no analytical anchor, leaving courts to decide these important cases based on subjective assessments of the fiscal health and long-term prospects of plans.

II. THE DECISION BELOW CONFLICTS WITH DECISIONS OF ANOTHER CIRCUIT AND ALL OTHER FEDERAL COURTS THAT HAVE CONSIDERED THE QUESTION IN ITS RULING THAT SELF-DEALING BY A PLAN FIDUCIARY IS EXEMPT FROM ERISA'S STRICT PROHIBITED TRANSACTION RULES SO LONG AS THE RESULT OF THE SELF-DEALING IS A FEE THAT APPEARS TO BE "REASONABLE."

The Court of Appeals' decision on the scope of ERISA's prohibited transaction rules conflicts with decisions by the Ninth Circuit and by every other court that has considered the question presented here. The ruling also contravenes the interpretation of the statute expressed in the 25 year-old regulation of the Secretary of Labor. As both the conflicting decisions and the regulation demonstrate, the Eighth Circuit transformed a narrow, limited exemption that is inapplicable to the facts of the case into a broad new license for self-dealing fiduciaries to manipulate plan assets to increase their own compensation.

The factual circumstances here involve self-dealing. The record showed that Granite's investment manager was able to inflate the valuations it assigned to the illiquid CMO investments and increase fees for itself, thus engaging in a *per se* prohibited transaction in violation of § 406(b)(1), 29 U.S.C. § 1106(b)(1). No issue of the "reasonableness" of an arms-length transaction is presented. Even a seemingly reasonable *rate* of compensation, when applied to asset valuations that have been inflated by a self-dealing investment manager fiduciary, cannot result in a "reasonable" amount of compensation.

As the conflicting decisions recognize, the law is to be strictly construed in favor of protecting plans and their participants. This Court has emphasized that ERISA prohibited transaction rules are intended "to bar categorically a transaction that was likely to injure the pension plan." *Commissioner v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 160 (1993). Courts therefore must give a "tight reading of exemptions from comprehensive [statutory] schemes" such as ERISA. *John Hancock Mut. Life Ins. Co. v. Harris Trust & Savings Bank*, 510 U.S. 86, 97 (1993).

The Eighth Circuit nevertheless ruled that the self-dealing violation inherent in Granite's manager assigning values to the assets that were the basis for computing its own compensation was exempt from prohibited transaction rules under ERISA § 408(c)(2), 29 U.S.C. § 1108(c)(2). This narrowly-drawn provision provides that nothing in § 406(b) "shall be construed to prohibit any fiduciary from – (2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; . . . ." 88a-89a. As the conflicting decisions hold, this limited permission to "receiv[e] . . . compensation" is not a license to self-deal and unilaterally set one's own compensation from the plan. The Secretary of Labor, in urging rehearing below, explained that, "On its face, section 408(c)(2) speaks to the amount of compensation a fiduciary may receive; it does not speak to the manner in which that compensation is determined," which is an issue instead addressed by the self-dealing prohibition of § 406(b). Secretary of Labor Amicus Br. in Support of Pet. for Rehearing 15 (May 23, 2002).

A. The Structure of ERISA's Prohibited Transaction Rules

By way of statutory overview of the question presented, ERISA §§ 408(b) and (c) deal solely with the general threshold issue of a plan paying money to a fiduciary or other party in interest for services rendered. This exchange from plan to

fiduciary, based on a permissible arms-length transaction, always would be forbidden without an exemption from the prohibited transaction rules that generally bar plan payments to fiduciaries.

The longstanding Department of Labor regulation on prohibited transactions makes clear that the limited provision relied upon by the Court of Appeals creates no exemption. The regulation states that "a fiduciary may not use the authority, control or responsibility which makes such a person a fiduciary to cause a plan to pay an additional fee to such fiduciary." 29 C.F.R. § 2550.408b-2(e)(1) (1977). The statute is intended to "deter [fiduciaries] from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act." *Id.*

The regulation emphasizes that when a fiduciary goes beyond merely "receiving" compensation and instead engages in a transaction that is subject to a conflict of interest defined under § 406(b), the prohibited transaction rules fully apply and no exemption is available. For example, § 408(b)(2) "does not contain an exemption from acts described in section [4]06(b)(1) of the Act (relating to fiduciaries dealing with assets of the plans in their own interest or for their own account . . .)." 29 C.F.R. § 2550.408b-2(a).

The regulation likewise explains that § 408(c)(2) does not establish a new exemption but only clarifies what is "reasonable" compensation under certain stated circumstances: "Section 408(c)(2) of the Act and §§ 2550.408c-2(b)(1) through 2550.408c-2(b)(4) clarify what constitutes reasonable compensation for such services." 29 C.F.R. § 2550.408c-2(a). By their very terms, all three subparts of § 408(c) deal narrowly with the provision of benefits and compensation between a plan and a person who is also receiving compensation from an employer or union, and with such person's concurrent service as a fiduciary. 88a-89a. "Read as a whole, § 408(c) functions as a series of assurances to fiduciaries that they may still retain other roles with respect to the plan [*i.e.* receive plan benefits

and compensation for services rendered, and serve as officers]." Secretary of Labor Amicus Br. in Support of Pet. for Rehearing 14 (May 23, 2002).

This longstanding interpretation of the statute by the agency charged with its enforcement should be accorded particular deference. *Barnhart v. Walton*, U.S. , 122 S. Ct. 1265, 1270-71 (2002). As a matter of statutory coherence as well, it is not logical to conclude that § 406(b) prohibits self-dealing and that § 408(b) provides no exemption (as the District Court recognized, 1999 D.Ct. Mem. at 24-25, 64a), but then treat the much narrower § 408(c) as an exemption for the very same conduct.

B. The Court of Appeals' Decision Conflicts With the Decisions of the Ninth Circuit and Every Other Federal Court that Has Considered the Application of § 408(c) to Claims of Fiduciary Self-Dealing.

Given this structure of the statute and the Secretary of Labor's longstanding regulation, the Eighth Circuit's decision conflicts with the rulings by all other courts that have considered the scope of § 408(c)(2). They uniformly agree that neither § 408(b) nor § 408(c) provides any exemption for self-dealing transactions prohibited under § 406(b).

The decision squarely conflicts with *Patelco Credit Union v. Sahni*, 262 F.3d 897 (CA9 2001), in which the Ninth Circuit ruled that § 408(c)(2) provides no exemption for self-dealing. After reviewing the structure of the statute, the Department of Labor regulation, and the caselaw, the Ninth Circuit concluded that "the reasonable compensation provision does not apply to fiduciary self-dealing." *Patelco*, 262 F.3d at 910-11.

The decision also conflicts with those of six District Courts from four different Circuits. *See Chao v. Graf*, No. CV-N-01-0698-DWH, 2002 WL 1611122 * 9 n.7 (D. Nev. Feb. 1, 2002) (following *Patelco*); *LaScala v. Scrufari*, 96 F. Supp.2d 233, 238-39 (W.D.N.Y. 2000) ("none of section 408's exemptions interact with section 406(b)'s prohibitions"); *Whitfield v. Tomasso*, 682 F. Supp. 1287, 1304 (E.D.N.Y. 1988) ("the

exemptive provisions of section 408(b)(2) and section 408(c)(2) apply only to violations of section 406(a), not violations of section 406(b)"); *Lowen v. Tower Asset Mgmt., Inc.*, 653 F. Supp. 1542, 1554-55 (S.D.N.Y. 1987) (DOL regulations "provide that acts otherwise prohibited by § 406(b) are not exempted under § 408(b)(2)"), *aff'd*, 829 F.2d 1209 (2d Cir. 1987); *Donovan v. Daugherty*, 550 F. Supp. 390, 404 nn.3-4, 409 (S.D. Ala. 1982) ("there are no applicable exemptions to the § 406(b) violations;" "exemption provided by section 408(c)(2) applies only to violations of section 406(a)"); *Gilliam v. Edwards*, 492 F. Supp. 1255, 1262-64 (D.N.J. 1980) ("§ 1108(b)(2) provides no shelter for § 1106(b)(1) 'self-dealing' transactions involving conflicts of interest relating to fiduciaries dealing with plan assets in their own interest;" regulation "intimates that § 1108(c)(2) and § 1106(b)(1) do not interact").

These decisions reach a conclusion that is the opposite of the Eighth Circuit's, but the court did not attempt to reconcile its contrary approach. By treating the narrow provision of § 408(c)(2) as a broad exemption that licenses self-dealing, the decision below conflicts with the decisions of every other Circuit and District Court that has considered this question, the 25 year-old Department of Labor regulation, as well as this Court's precedent on the strict construction and enforcement of prohibited transaction rules.

As demonstrated by the participation below of both the Secretary of Labor and the Pension Benefit Guaranty Corporation, the questions presented are critical to effective enforcement of the ERISA statute. In this time of financial wrongdoing threatening the retirement security of millions of citizens, it is especially appropriate for the Court to intervene to resolve these conflicts among the Circuits.

CONCLUSION

Petitioners respectfully pray that the Petition be granted and that a writ of certiorari issue to the Court of Appeals for the Eighth Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT SUBMITTED MARCH 12, 2001 AND FILED MARCH 26, 2002

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 00-2214

Carol Harley, et al.,

Plaintiffs - Appellants,

v.

Minnesota Mining And Manufacturing Company,

Defendant - Appellee.

No. 01-1213

Carol Harley, et al.,

Plaintiffs - Appellants,

v.

Guillo Agostini, et al.,

Defendants - Appellees.

Submitted: March 12, 2001

Filed: March 26, 2002

Appendix A

Appeals from the United States District Court
for the District of Minnesota

Before LOKEN, MURPHY, and BYE, Circuit Judges.

LOKEN, Circuit Judge.

These are two class actions against Minnesota Mining and Manufacturing Company ("3M") and certain 3M employees by participants and beneficiaries of the 3M Employee Retirement Income Plan (the "Plan"). The Plan is subject to the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §§ 1001-1461. Plaintiffs allege that 3M breached its fiduciary duties under ERISA by failing to adequately investigate and monitor a $20 million investment of Plan assets in a hedge fund, and by failing to discover and remedy a prohibited transaction involving the fund advisor's compensation. Plaintiffs appeal the district court's[1] grant of summary judgment dismissing their claims. The principal issue is whether the court erred in dismissing plaintiffs' failure to investigate and monitor claims because the Plan is a defined benefit plan with a substantial surplus. We affirm.[2]

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1. The HONORABLE JOHN R. TUNHEIM, United States District Judge for the District of Minnesota.

2. The court has received and considered amicus briefs from the Secretary of Labor and the American Association of Retired Persons on behalf of plaintiffs, and from the Association of Private Pension and Welfare Plans and the ERISA Industry Committee on behalf of 3M.

Appendix A

I. Background.

3M is responsible for directing the investment of Plan assets, a responsibility delegated to 3M's Pension Asset Committee (the "PAC"). In exercising this discretionary authority, both 3M and the PAC are Plan fiduciaries. *See* 29 U.S.C. § 1002(21)(A). This action arose out of a $20 million investment of Plan assets in the Granite Corporation ("Granite"), a hedge fund that invested primarily in collateralized mortgage obligations (CMOs) — fixed income securities that are derived from and secured by pools of private home mortgages.[3] Granite was marketed to 3M's pension staff as an investment that would "maximize a consistent rate of return" for its investors while investing in "low risk instruments." Achieving a high rate of return hinged on using leverage, which increased the risk to investors from changes in market interest rates. Granite represented that it would hedge this risk by using sophisticated quantitative models to maintain a market-neutral investment position.

The Plan invested in Granite in 1990. The value of its Granite investment increased to $34 million by February 1994, but a significant rise in interest rates in March 1994 devastated the CMO market. Granite declared bankruptcy in April 1994, and the Plan lost its entire investment.[4] On the

3. For a description of CMOs and the investment risks they entail, *see Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1022-23 (4th Cir. 1997).

4. The Plan has joined a lawsuit against Granite's investment advisor and various broker-dealers that sold CMOs to Granite in which plaintiffs allege fraud based on Granite's failure to maintain a market neutral position and on the overvaluing of Granite securities. *See ABF Capital Mgmt. v. Askin Capital Mgmt., L.P.*, 957 F. Supp. 1308, 1317 (S.D.N.Y.1997).

other hand, between 1993 and 1998, 3M's voluntary contributions to the Plan exceeded ERISA's minimum funding requirements by $683 million, and the fair market value of the Plan's assets increased from approximately $3.4 billion in 1995 to over $6.3 billion in 1999. The Plan has never failed to pay benefits to its beneficiaries over its sixty-seven year life.

In investing Plan assets, a fiduciary must act "with the care, skill, prudence, and diligence [of] a prudent man acting in a like capacity and familiar with such matters." *Felber v. Estate of Regan*, 117 F.3d 1084, 1086 (8th Cir. 1997), quoting 29 U.S.C. § 1104(a)(1)(B). A fiduciary that breaches this duty is liable "to make good to such plan any losses to the plan resulting from each such breach." 29 U.S.C. § 1109(a). The Secretary of Labor and plan participants, beneficiaries, and fiduciaries may sue "for appropriate relief under section 1109." 29 U.S.C. § 1132(a)(2).

Plaintiffs filed this action in June 1996, alleging that 3M is liable to the Plan under § 1109 because it breached its fiduciary duties by failing to investigate Granite adequately prior to investing in 1990; by thereafter failing to monitor properly the Granite investment; and by allowing the Plan to enter into a prohibited performance-based compensation agreement with Granite's investment advisor. Following discovery, the district court granted 3M summary judgment on the prohibited transaction claim because plaintiffs presented no evidence that the challenged compensation was unreasonable. *Harley v. Minnesota Mining & Mfg. Co.*, 42 F. Supp.2d 898, 911 (D. Minn. 1999). The court denied 3M summary judgment on the failure to investigate and

monitor claims because "a reasonable fact finder could conclude that 3M's investigatory and monitoring methods and actions were below ERISA's standard of reasonable care." 42 F. Supp.2d at 907. However, the court ruled that the Plan did not suffer a remediable loss if 3M's voluntary contributions created an offsetting surplus and invited further discovery and a renewed motion for summary judgment on that issue. *Id.* at 914-15. After this ruling, plaintiffs filed the second action asserting the same claims against seven members of 3M's PAC.

After further discovery on the surplus issue, 3M renewed its motion for summary judgment. The district court concluded that the Plan has a sufficient surplus and dismissed the failure to investigate and monitor claims because the Granite investment caused no "losses to the plan" for purposes of 29 U.S.C. § 1109(a). In a subsequent order, the court held that the claims against the PAC defendants are barred by collateral estoppel and dismissed plaintiffs' second suit. Plaintiffs appeal the dismissal of their claims in both actions.

II. The Failure To Investigate and Monitor Claims.

Plaintiffs allege that 3M violated the prudent-man standard of care when it invested Plan assets in Granite without adequate investigation and monitoring. To recover, plaintiffs must prove a breach of this fiduciary duty and loss to the Plan. *See Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917 (8th Cir. 1994). The district court concluded that plaintiffs could not prove the requisite loss to the Plan:

> The Court believes, in the unique circumstances of this case, that if 3M indeed has contributed amounts sufficient to put the Plan's portfolio in a surplus position, the Granite investment has not caused [plaintiffs] or the Plan any cognizable harm.

42 F. Supp.2d at 912. The "unique circumstances" to which the court referred are the relevant features of a defined benefit plan, which were recently described by the Supreme Court in *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-40 (1999) (quotations omitted):

> Such a plan, as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment. . . . [T]he employer typically bears the entire investment risk and — short of the consequences of plan termination — must cover any underfunding as the result of a shortfall that may occur from the plan's investments. . . . Given the employer's obligation to make up any shortfall, no plan member has a claim to any particular asset that composes a part of the plan's general asset pool. . . . Since a decline in the value of a plan's assets does not alter accrued benefits, members similarly have no entitlement to share in a plan's surplus. . . .

On appeal, plaintiffs and the Secretary of Labor as amicus vigorously attack the district court's conclusion that there was no loss to the Plan. The Secretary warns that a decision "that an employer-fiduciary is not liable for losses caused by

fiduciary breaches when a defined benefit pension plan is overfunded will have a substantial impact on the ability of the Secretary to enforce the statute." We agree that the district court's focus on "losses to the plan" — an essential element of the fiduciary's liability under § 1109(a) — was misplaced. If there is no loss to the plan, then no one may recover from the fiduciary on behalf of the plan, including the Secretary. That is far more than need be decided in this case. Moreover, the district court's conclusion that there was no loss to the Plan seems contrary to the plain meaning of § 1109(a). 3M concedes, as it must, that the Plan's $20 million investment in Granite became worthless after Granite declared bankruptcy in April 1994. This loss reduced the pool of Plan assets. We cannot agree with the court that "the Granite investment has not caused . . . the Plan any cognizable harm." 42 F. Supp.2d at 912.

But that does not mean we disagree with the district court's decision to dismiss these claims. In our view, the proper focus is on whether plaintiffs have standing to bring an action under § 1132(a)(2) to seek relief under § 1109 for this particular breach of duty, given the unique features of a defined benefit plan as identified in *Hughes Aircraft.* In a defined benefit plan, if plan assets are depleted but the remaining pool of assets is more than adequate to pay all accrued or accumulated benefits, then any loss is to plan surplus. As *Hughes Aircraft* made clear, plaintiffs as Plan beneficiaries have no claim or entitlement to its surplus. If the Plan is overfunded, 3M may reduce or suspend its contributions. *See Hughes Aircraft,* 525 U.S. at 440. If the Plan's surplus disappears, it is 3M's obligation to make up any underfunding with additional contributions. If the Plan

terminates with a surplus, the surplus may be distributed to 3M. *See* 29 U.S.C. § 1344(d); *Dame v. First Nat'l Bank of Omaha*, 217 F.3d 1018, 1019 (8th Cir. 2000). Thus, the reality is that a relatively modest loss to Plan surplus is a loss only to 3M, the Plan's sponsor.

In these circumstances, we agree with the other half of the district court's conclusion — "the Granite investment has not caused [plaintiffs] . . . any cognizable harm." 42 F. Supp.2d at 912. The question, then, is whether plaintiffs may nonetheless sue under 29 U.S.C. § 1132(a)(2) to recover on behalf of the Plan. We answer that question in the negative because, in our view, two critical factors support this construction of these ERISA remedial provisions.

First, a contrary construction would raise serious Article III case or controversy concerns. The doctrine of standing serves to identify cases and controversies that are justiciable under Article III. An "irreducible constitutional minimum of standing" is that "plaintiff must have suffered an 'injury in fact' — an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (quotations and citations omitted). Although a statute may broaden the class of redressable injuries, the Supreme Court has never held that Congress may do away with the Article III requirement of "concrete injury." *Id.* at 578. These concerns have led the Court to construe the antitrust standing conferred by Section 4 of the Clayton Act, 15 U.S.C. § 15 ("any person . . . injured in his business or property by reason of anything forbidden in the antitrust laws") as not extending to injuries

that are too remote or indirect or speculative. *See, e.g., Associated Gen'l Contractors of Cal., Inc. v. Cal. State Council of Carpenters,* 459 U.S. 519, 535-46 (1983). Thus, the limits on judicial power imposed by Article III counsel against permitting participants or beneficiaries who have suffered *no* injury in fact from suing to enforce ERISA fiduciary duties on behalf of the Plan.

Unlike the dissent, we do not find this concern resolved by dicta in the Supreme Court's recent decision in *Vermont Agency of Natural Res. v. United States ex. rel Stevens*, 529 U.S. 765, 772 (2000), that designation as a statutory agent for another party "would perhaps suffice" to confer standing to recover an injury suffered by that party. In § 1132(a)(2), Congress generally authorized the Secretary, participants, beneficiaries, and fiduciaries to sue for appropriate relief on behalf of the plan. If the statute authorized any stranger to the plan to bring such an action, would that suffice to confer standing? Surely not, for "Article III forecloses the conversion of courts of the United States into judicial versions of college debating forums." *Valley Forge Christian College v. Americans United for Separation of Church & State, Inc.*, 454 U.S. 464, 473 (1982). The question in *Vermont Agency* was the standing of private parties to bring *qui tam* lawsuits on behalf of the United States. The Court answered that question in the affirmative for two reasons. First, the *qui tam* statute partially assigned the government's claim to the private *qui tam* relator; here, on the other hand, § 1132(a)(2) contains no such assignment. Second, the long tradition of *qui tam* actions in England and the American colonies persuaded the Court that such actions are cases and controversies for purposes of Article III standing. By contrast,

the law of trusts is the starting point in interpreting and applying ERISA's fiduciary duties. *See, e.g.*, *Varity Corp. v. Howe*, 516 U.S. 489, 496-97 (1996). Under the law of trusts, "[a] particular beneficiary cannot maintain a suit for a breach of trust which does not involve any violation of duty to him." RESTATEMENT (SECOND) OF TRUSTS § 214 cmt. b.

Second, "[t]he primary purpose of [ERISA] is the protection of individual pension rights." H.R. REP. No. 93-533 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4639. Thus, the basic remedy for a breach of fiduciary duty is "to restor[e] plan participants to the position in which they would have occupied but for the breach of trust." *Martin v. Feilen*, 965 F.2d 660, 671 (8th Cir. 1992) (quotation omitted). Here, the ongoing Plan had a substantial surplus before and after the alleged breach and a financially sound settlor responsible for making up any future underfunding. The individual pension rights of Plan participants and beneficiaries are fully protected. Indeed, those rights would if anything be adversely affected by subjecting the Plan and its fiduciaries to costly litigation brought by parties who have suffered no injury from a relatively modest but allegedly imprudent investment. Thus, the purposes underlying ERISA's imposition of strict fiduciary duties are not furthered by granting plaintiffs standing to pursue these claims. In addition to the Article III constitutional limitations, prudential principles bear on the question of standing. One of those principles is to require that "plaintiff's complaint fall within the zone of interests to be protected or regulated by the statute . . . in question." *Valley Forge*, 454 U.S. at 475 (quotation omitted).

For these reasons, we conclude that plaintiffs' failure to investigate and monitor claims were properly dismissed if the Plan's surplus was sufficiently large that the Granite investment loss did not cause actual injury to plaintiffs' interests in the Plan.

Plaintiffs challenge the district court's conclusion that the Plan's surplus is adequate for this purpose as a matter of law. Plaintiffs argue that 3M must establish that the Plan is fully funded "using the methodology mandated by ERISA." In this regard, plaintiffs posit that ERISA mandates use of either the plan-termination valuation method prescribed when a defined benefit plan is spun off, transferred, or merged into another, *see* 29 U.S.C. § 1058; or the method of determining whether a plan is fully funded in the "RPA 94" minimum funding standard adopted by Congress in 1994 to assure that defined benefit plans are adequately funded, *see* 29 U.S.C. § 1082(d). (For an explanation of the RPA 94 standard, *see* H.R. REP. NO. 103-826, at 209 (1994), reprinted in 1994 U.S.C.C.A.N. 3773, 3981.)

In our view, plaintiffs frame this issue incorrectly. Surplus is not an affirmative defense that 3M must prove. Rather, absence of adequate surplus is an element of plaintiffs' standing under § 1132(a)(2) — proof they are suing to redress a loss to the Plan that is an actual injury *to themselves*. Plaintiffs have no evidence that the Plan will terminate in the foreseeable future. Therefore, they may not satisfy this element by proposing a termination valuation method because a hypothetical termination has no relevance to the issue of whether they have suffered injury in fact. As the district court observed, "ERISA does not require

[ongoing] plans to maintain funding at termination levels, a fact that the Supreme Court implicitly recognized in *Hughes*." (Mar. 29, 2000 Mem. & Order at 13.) Likewise, the district court properly rejected plaintiffs' contention that the Plan must be 100% fully-funded under the RPA 94 valuation method. The statute does not use that funding level to determine whether additional contributions are required, and 3M has never been required to make an additional contribution.

We agree with the district court that "[b]y nearly any measure, the 3M Plan is a robust, richly-funded, ongoing plan." (*Id.* at 18.) The actuarial value of the Plan's assets exceeded its actuarial accrued liabilities in 1993, before Granite's bankruptcy, and in every year thereafter. 3M has contributed $683 million more than its minimum funding requirements since the loss of the $20 million Granite investment. Plaintiffs failed to prove the absence of a substantial surplus under any relevant valuation method. In these circumstances, the failure to investigate and monitor claims were properly dismissed because plaintiffs suffered no injury-in-fact.[5]

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5. This decision does not insulate a fiduciary who invests the assets of an overfunded defined benefit plan from liability to the plan for breach of the duty to invest prudently. Both the Secretary of Labor and any party with a reversionary interest in the plan's surplus have standing to sue under 29 U.S.C. § 1132(a)(2).

III. The Prohibited Transaction Claim.

The Plan agreed to pay Granite's investment advisor, Askin Capital Management ("ACM"), a fee contingent on the success of the Granite investment. The Plan paid ACM approximately $1.17 million in March 1993, the only fee paid during the life of the investment. ACM was a Plan fiduciary because it had discretion to invest on behalf of the Plan. Plaintiffs argue that ACM's fee arrangement violated the prohibition against a fiduciary dealing with plan assets for its own account, *see* 29 U.S.C. § 1106(b)(1), because ACM determined the value of Granite's holdings without an independent valuation; and that 3M breached its fiduciary duty to the Plan by failing to discover and remedy this prohibited transaction, *see* 29 U.S.C. § 1105(a)(2). The district court dismissed this claim because plaintiffs presented no evidence the ACM fee was unreasonable. 42 F. Supp.2d at 909-11. We agree.

Section 1106(b)(1) prohibits a fiduciary from "deal[ing] with the assets of the plan in his own interest or for his own account." However, § 1108(c)(2) provides that "[n]othing in section 1106 of this title shall be construed to prohibit any fiduciary from . . . receiving any reasonable compensation for services rendered . . . in the performance of his duties with the plan." 3M introduced uncontradicted expert testimony that the compensation paid to ACM was reasonable.

Plaintiffs counter this factual showing with a legal argument — that § 1108(c)(2) does not apply to prohibited transactions under § 1106(b) but only clarifies the

exemption provided in § 1108(b)(2). Plaintiffs rely for this argument on their interpretation of a regulation, 29 C.F.R. § 2550.408c 2(a). But in this case, the general prohibition in § 1106(b)(1) — that a fiduciary should not deal in plan assets for its own account — is alleged to have been violated when a fiduciary influenced its own compensation for investment services. At least in this situation, the plain language of § 1108(c)(2) sensibly insulates the fiduciary from liability if the compensation paid was reasonable. We reject plaintiffs' reading of the ambiguous regulation because it conflicts with an unambiguous statute. Moreover, the legislative history of § 1108 does not support the contention that the § 1108(c)(2) exemption merely clarifies § 1108(b)(2). *See, e.g.*, H.R. CONF. REP. NO. 93-1280 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5092; *Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1216 & n.4 (2d Cir.1987). Thus, summary judgment was proper because plaintiffs failed to rebut the uncontradicted evidence that ACM's compensation was reasonable.

For the foregoing reasons, we affirm the grant of summary judgment dismissing plaintiffs' claims against 3M. Because those claims were properly dismissed on the merits, we need not consider plaintiffs' contention that the district court's class notice omitted pertinent information and was not fair and neutral.

IV. Dismissal of the Claims Against PAC Members.

In the second case, plaintiffs sued seven members of 3M's Pension Assets Committee asserting the same breaches of fiduciary duty. This action was stayed by stipulation until the district court ruled on the issue of whether the Plan had

an adequate surplus. The district court then granted summary judgment in this action, concluding that collateral estoppel bars plaintiffs' failure to investigate and monitor and prohibited transaction claims against the PAC defendants. Plaintiffs appeal, arguing that collateral estoppel does not bar the failure to investigate and monitor claims because the district court's decision in favor of 3M was based upon a "special defense" available only to fiduciary-employers. Collateral estoppel bars these claims only if the PAC defendants are entitled to summary judgment on an issue that was "actually and necessarily determined" in plaintiffs' action against 3M. *United States v. Gurley*, 43 F.3d 1188, 1198 (8th Cir.1994).

Plaintiffs assert that the district court erred in concluding that the PAC defendants' "liability is identical to that of the employer [3M] for the purpose of establishing the required element of a loss to the Plan." But we have not affirmed the district court's ruling that the Plan's surplus meant there were no "losses to the plan." Rather, we conclude that the Plan's surplus deprived plaintiffs of standing to sue because they suffered no injury in fact. This conclusion applies as well to defeat plaintiffs' claims against the PAC defendants. Thus, the Plan surplus issue, which was "actually and necessarily" litigated in the 3M case, bars plaintiffs' claims in this second case by reason of the doctrine of collateral estoppel.

In this second appeal, plaintiffs again challenge the merits of the district court's decision dismissing their claims against 3M. We reject these contentions for the reasons stated in Parts II and III of this opinion.

The judgments of the district court are affirmed.

BYE, Circuit Judge, concurring in part and dissenting in part.

I agree the district court erred by concluding the collapse of Granite caused no loss to the Plan. I also agree with the court's resolution of the prohibited transaction claim. But I disagree the plaintiffs lack standing to bring breach of fiduciary duty claims under 29 U.S.C. § 1132(a)(2). The court sidesteps the question whether, consistent with Article III, plan participants or beneficiaries may bring claims under § 1132(a)(2) for injuries suffered only by the Plan, reasoning that such a construction "would raise serious Article III case or controversy concerns." *Ante* at 7. But we do not have the luxury of avoiding that construction. Section 1132(a)(2) only permits participants or beneficiaries to bring suit *in a representative capacity* to remedy an injury to the Plan itself. *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 142 n.9, 144 (1985); *see also Physicians Healthchoice, Inc. v. Trs. of Auto. Employee Benefit Trust*, 988 F.2d 53, 55 (8th Cir. 1993). Thus, we have no choice but to address the Article III question head-on.

I believe the plaintiffs have standing. They satisfy the case-or-controversy requirements of Article III by standing in the shoes of a party that clearly has standing — the Plan itself. In *Vt. Agency of Natural Res. v. United States ex. rel Stevens*, the Supreme Court held a *qui tam* relator had Article III standing to sue under the False Claims Act because the United States had partially assigned its claim to the relator. 529 U.S. 765, 773 (2000). But the Supreme Court also suggested a person has standing to bring an action on behalf of a complaining party, so long as the person has no individual interest in the case, and is "simply the statutorily designated

agent of the [complaining party]." *Id.* at 772. The latter point proves instructive in this case because § 1132(a)(2) authorizes plan participants and beneficiaries to bring claims on behalf of the Plan (the complaining party), but not on their own behalf. *See Russell, supra.* Therefore, under *Stevens*, I believe the plaintiffs may bring suit under § 1132(a)(2) because the Plan's injuries suffice to confer Article III standing.

I do not find the court's reliance on the "zone of interests" test particularly helpful in deciding whether the plaintiffs have standing. The Plan beneficiaries are certainly not strangers to the Plan, *ante* at 7, and § 1132(a)(2) authorizes them to represent the Plan irrespective of whether the fiduciary breach affects a defined benefit plan or a defined contribution plan. The zone of interests test presents a question of "*statutory* standing," *Steel Co. v. Citizens for a Better Env't,* 523 U.S. 83, 97 (1998) (emphasis in original), with prudential standing requirements satisfied "when the *injury* asserted by a plaintiff arguably falls within the zone of interests to be protected or regulated by the statute in question." *Fed. Election Comm'n v. Akins*, 524 U.S. 11, 20 (1998) (internal punctuation and quotation omitted) (emphasis added). Here, the Plan's injuries are at issue, and the plaintiffs' suit certainly satisfies the "statutory" zone of interests tests when the statute itself authorizes plan beneficiaries to act for the Plan in a representative capacity.

I respectfully dissent in part.

A True copy.

Attest.

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 00-2214

Carol Harley, et al.,

Plaintiffs - Appellants,

v.

Minnesota Mining And Manufacturing Company,

Defendant - Appellee.

No. 01-1213

Carol Harley, et al.,

Plaintiffs - Appellants,

v.

Guillo Agostini, et al.,

Defendants - Appellees.

Appeals from the United States District Court
for the District of Minnesota.

Appendix A

JUDGMENT

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is hereby ordered and adjudged that the judgment of the district court in this cause is affirmed in accordance with the opinion of this Court.

March 26, 2002

A true copy.

ATTEST s/ Michael E. Gans

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA, FOURTH DIVISION DATED MARCH 29, 2000

Civil No. 4-96-488 (JRT/RLE)

CAROL HARLEY; *et al.*, individually and on behalf of others similarly situated,

Plaintiffs,

v.

MINNESOTA MINING AND MANUFACTURING COMPANY,

Defendant.

MEMORANDUM OPINION AND ORDER

This class action arises out of defendant Minnesota Mining and Manufacturing Co.'s ("3M") alleged failure to invest prudently the assets of the 3M Employee Retirement Plan ("the Plan"). The Court certified a class of all participants and beneficiaries of the Plan on September 25, 1997, and thereafter the parties filed a number of dispositive motions. In a Memorandum Opinion and Order dated March 31, 1999, the Court denied 3M's motion for summary judgment, but permitted the parties to move for leave to file another summary judgment motion and for additional discovery regarding whether the plan has surplus funds. *See Harley v. Minnesota Mining and Mfg. Co.*, 42 F. Supp. 2d 898, 914-15 (D. Minn. 1999). In response, 3M moved for leave to file a

summary judgment motion, which the Court granted by Order dated May 4, 1999. The Court also granted plaintiffs' motion to conduct further discovery in part. Discovery is now complete, and the parties have been fully heard on this issue. For the reasons set forth below, the Court grants 3M's motion for summary judgment.

BACKGROUND

The facts underlying this case are fully set forth in the Court's March 31, 1999 Order. *See Harley*, 42 F. Supp. 2d at 900-04. The pertinent facts may be summarized as follows. The Plan, which has total assets in excess of $6 billion and encompasses thousands of participants and beneficiaries, is a "defined benefit plan" subject to ERISA, 29 U.S.C. §§ 1001 *et seq.* 3M is a fiduciary of the Plan and is responsible for overseeing the investment of Plan assets. 3M delegated this responsibility to its "Pension Asset Committee." In 1990, this committee decided to invest $20 million of Plan assets in Granite Corporation ("Granite"), a "hedge fund" containing collateralized mortgage obligations ("CMOs"). Following a significant rise in interest rates in February and March 1994, Granite began experiencing severe difficulties, and ultimately collapsed. 3M wrote off the investment in its entirety.

To establish a claim for breach of fiduciary duty under ERISA, a plaintiff must show both a breach of duty and a prima facie case of loss to the plan or ill-gotten profit to the fiduciary. *See Martin v. Feilen*, 965 F.2d 660, 671 (8th Cir. 1992). The burden of persuasion then shifts to the fiduciary to prove that the loss was not caused by, or the profit

not attributable to, the breach. *See id.* In their amended complaint,[1] plaintiffs allege that 3M breached its fiduciary duties under ERISA by failing to investigate, monitor, and understand all aspects of the Granite investment. Plaintiffs further contend that the total depletion of plan assets resulting from this investment ranges anywhere from $29.6 million to $102.8 million. *See* Pls.' Ex. A, Expert Report of Thomas Levy,¶ 22.

In its earlier motion for summary judgment, 3M contended that because it voluntarily contributed over $500 million in excess of plan funding requirements, plaintiffs could not establish an essential element of their case, namely, a loss to the Plan. After oral argument on that motion but prior to the Court's decision, the Supreme Court decided *Hughes Aircraft v. Jacobson*, 525 U.S. 432 (1999). In *Hughes*, the employer used surplus plan assets to fund newly created early retirement and non-contributory benefit structures. *See id.* at 436. Among other claims, the plaintiffs contended that this use of the surplus violated ERISA's vested benefits and anti-inurement provisions. *See id.* at 439. The Court concluded that because participants in a defined benefit plan have no claim to surplus funds, those claims must fail. *See id.* at 441-43.

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1. Both the parties and the Court have relied on the amended complaint as setting forth the claims of the class. Although 3M filed an answer to the amended complaint, as of the date of oral argument the amended complaint itself was not listed anywhere on the docket sheet and apparently was misplaced. At the Court's request, however, plaintiffs have corrected this deficiency; the Court notes it only to explain the late filing date.

This Court found the *Hughes* analysis instructive and held that *Hughes* controlled the plaintiffs' breach of fiduciary claim. *See Harley*, 42 F. Supp. 2d at 913. Thus, if 3M can show that the Plan has a surplus, the Granite investment caused no loss to the Plan and plaintiffs cannot prevail. *See id.* at 914. Because the record did not reflect whether the Plan has a surplus as defined in ERISA and *Hughes*, however, the Court denied 3M's motion for summary judgment. *See id.* Armed with further discovery and analysis, the parties are again before the Court disputing the issue of a funding surplus.

ANALYSIS

A. Standard of Review

Summary judgment is appropriate where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. *See* Fed. R. Civ. P. 56(c). Only disputes over facts that might affect the outcome of the suit under the governing substantive law will properly preclude the entry of summary judgment. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). In considering a motion for summary judgment, a court is required to view the facts in a light most favorable to the nonmoving party. *See Lomar Wholesale Grocery, Inc. v. Dieter's Gourmet Foods, Inc.*, 824 F.2d 582, 585 (8th Cir. 1987). Summary judgment is to be granted only where the evidence is such that no reasonable jury could return a verdict for the nonmoving party. *See Anderson*, 477 U.S. at 248. The moving party bears the burden of bringing forward sufficient evidence

to establish that there are no genuine issues of material fact and that the movant is entitled to judgment as a matter of law. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

B. Methods for Measuring Plan Funding

The parties have identified a number of possible methods for measuring whether the Plan has a surplus. Each method is explained below.

Financial Accounting Standard 35

Under ERISA, defined benefit plans such as 3M's are required to file an annual report. *See* 29 U.S.C. § 1024(a)(1). The annual report must include the information described in ERISA § 103, 29 U.S.C. § 1023, which, among other items, requires a financial statement and opinion. *See* 29 U.S.C. § 1023(a)(1)(B)(i). The provision relating to the financial statement and opinion states, in pertinent part, as follows:

> [T]he administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual reports by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis

> consistent with that of the preceding year. . . . The opinion by the independent qualified public accountant shall be made a part of the annual report.

29 U.S.C. § 1023(a)(3)(A). For plans with one hundred or more participants, ERISA regulations permit the annual report to be filed via a form, known as "Form 5500," with attached schedules. *See* 29 C.F.R. § 2520.103-1(b)(1). Such reports must also include separate financial statements, if the statements are prepared for the purpose of the accountant's review under § 1023(a)(3)(A). *See* 29 C.F.R. § 2520.103-1(b)(2). Thus, as the interplay of these statutes and regulations indicates, the annual report's financial statements must be prepared in accordance with generally accepted accounting principles ("GAAP").

To comply with the requirement that financial statements and schedules included in the annual report conform to GAAP, the Financial Accounting Standards Board developed Financial Accounting Standard 35, "Accounting and Reporting by Defined Benefit Pension Plans" ("FAS 35"). *See* Ex. B to Second Aff. of Steven L. Severson. The summary description which appears at the beginning of FAS 35 states that

> [t]he primary objective of a plan's financial statements is to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due. To accomplish that objective, the financial statements will include information regarding (a) the net assets available for benefits as of the end of the plan

> year, (b) the changes in net assets during the plan year, (c) the actuarial present value of accumulated plan benefits as of either the beginning or end of the plan year, and (d) the effects, if significant, of certain factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.

FAS 35, at i. Using the logic of FAS 35, a plan has a surplus whenever the plan's assets exceed the actuarial present value of accumulated plan benefits (also known as the present value of accrued benefits, or "PVAB"). Plan investment assets are measured at fair market value. *See* FAS 35, ¶ 11.

FAS 35 defines PVAB as "those future benefit payments that are attributable under the plan's provisions to employees' service rendered" to the date the information is presented. FAS 35, ¶ 16. In other words, the plan's liability consists of the amount of money needed now to pay all the currently accrued benefits as they come due. *See* FAS 35, ¶ 20. Certain assumptions underlie the calculation of PVAB in order to reflect the time value of money and the probability of payment. *See* FAS 35, ¶ 19. One important assumption is the rate of return on the plan's investments; higher rates yield a lower liability. For at least the last several years, the Plan has used a 9% rate for its FAS 35 calculation, in contrast to the Plan's actual annualized investment return of 14.5% over the last ten years. Overall, FAS 35 assumes that the plan is ongoing. *See* FAS 35, ¶ 20. As of January 1, 1999, using FAS 35 calculations, the Plan's assets totaled $6.3 billion and the plan's liabilities totaled $4.1 billion, leaving a surplus of $2.2 billion.

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Actuarial Accrued Liability

ERISA and the Internal Revenue Code together set a minimum funding standard for defined benefit plans. *See* 29 U.S.C. § 1082; 26 U.S.C. § 412. Plan sponsors are required to engage the services of an ERISA-enrolled actuary[2] to make assumptions necessary for calculating the minimum funding requirement. *See* 26 U.S.C. § 6059(b). Furthermore, the actuarial assumptions used to calculate funding must be reasonable. *See* 29 U.S.C. § 1082(c)(3)(A); 26 U.S.C. § 412(c)(3). The Plan's funding level is such that 3M has not been required to make a minimum contribution under § 412 or § 1082 since 1993, prior to the Granite loss.

To determine its minimum funding for the Plan, 3M uses the Actuarial Accrued Liability method ("AAL"). As explained in 3M's expert's report, AAL is calculated using the same assumptions used under FAS 35, except that AAL also reflects the impact of future salary growth on current benefits, which FAS 35 does not. *See* FAS 35, at ii. The AAL calculation thus results in greater liability for the Plan. 3M's expert compared the Plan's AAL to the actuarial value of assets ("AVA"), which is determined by adjusting the market value of assets for investment gains and losses during the preceding five years. This comparison yields an excess of assets over liability in the amount of $1.4 billion.

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2. Actuaries are enrolled by the Joint Board for the Enrollment of Actuaries, which was created by ERISA to set standards and qualifications for persons performing actuarial services for ERISA-covered plans. *See* 29 U.S.C. §§ 1241-42; 26 U.S.C. § 7701(a)(35).

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Contribution Surplus

Another method 3M proposes to measure the Plan's funding is what it terms "contribution surplus." This method is closely tied to the AAL method by which 3M calculates whether it must make any minimum contribution under § 1082 of ERISA and § 412 of the Internal Revenue Code. Although the AAL calculations indicated that 3M's minimum contribution for the years 1994-1999 has been zero, 3M contributed approximately $581 million to the Plan during those years. 3M terms this amount, plus an additional $101 million that it contributed in excess of the required minimum contribution in 1993, a "contribution surplus."

Termination

ERISA sets forth procedures to follow for plans that are being terminated. *See generally* 29 U.S.C. §§ 1341-1350. There are only three ways by which a single-employer plan such as 3M's may be terminated: a standard termination, a distress termination, or a termination instituted by the Pension Benefit Guaranty Corporation ("PBGC"). *See* 29 U.S.C. § 1341(a)(1); § 1342(a). Among other procedures, plans terminating under § 1341 must calculate the amount of the plan's assets and benefit liabilities as of the termination date. *See* 29 U.S.C. § 1341(b)(2)(A), (c)(2)(A). To accomplish the final distribution of assets, plan administrators generally must either purchase insured annuities to cover the benefit liabilities or provide a lump sum payment. *See* 29 U.S.C. § 1341(b)(3)(A), (c)(3)(B)(i). Furthermore, assets must be distributed in accordance with 29 U.S.C. § 1344. *See* 29 U.S.C. § 1341(b)(3)(A). The regulations implementing § 1344,

in turn, set forth the interest rates to be used in calculating the present value of accrued benefits for plans which have been placed into trusteeship by the PBGC.[3] *See* 29 C.F.R. part 4044, App. B. These rates are significantly lower than the interest rates used in calculating the present value of accrued benefits for purposes of annual reporting, thus resulting in a higher present value of benefits and greater liability. There is no dispute that, when calculated according to the rates set forth in the regulation, 3M's assets fall short of its liabilities. 3M likewise has offered no evidence that the plan contains assets sufficient to purchase annuities to cover its liabilities.[4]

Retirement Protection Act of 1994

As amended by the Omnibus Budget Reconciliation Act of 1987 ("OBRA"), Pub. L. 100-203, 101 Stat. 1330, and the Retirement Protection Act of 1994 ("RPA"), Pub. L. No. 103-465, 108 Stat. 5012, ERISA requires plan sponsors to make "deficit reduction contributions" when the plan reaches a certain level of underfunding. 29 U.S.C. § 1082(d); *see also* 26 U.S.C. § 412(l) (setting forth parallel provision

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3. The PBGC may place a plan into trusteeship whenever it determines that the plan is in financial trouble as specified in § 1342(a). *See* 29 U.S.C. § 1342(b). Plaintiffs do not contend that the 3M Plan is a candidate for trusteeship under these provisions.

4. While 3M refers separately to what it terms the "PBGC Distress Method" and the "Annuity Purchase Method," both these methods refer to plan terminations under 29 U.S.C. §§ 1341-1342. The difference lies only in whether the funds are distributed in lump sums or used to purchase annuities; for this reason, the Court groups them under the rubric "Termination."

in the Internal Revenue Code). To determine whether such a contribution is required, the level of funding is cast in terms of "current liability." 29 U.S.C. § 1082(d)(7); 26 U.S.C. § 412(1)(7). Current liability is calculated using ERISA-mandated interest rates and mortality tables. *See* 29 U.S.C. § 1082(d)(7)(C); 26 U.S.C. § 412(1)(7)(C). With exceptions not applicable here, the deficit reduction contribution requirement is not triggered unless the "funded current liability percentage" is less than 90%. 29 U.S.C. § 1082(d)(9)(A); 26 U.S.C. § 412(1)(9)(A). Funded current liability percentage is the result of the value of the plan's assets divided by the plan's current liability. *See* 29 U.S.C. § 1082(d)(8)(B); 26 U.S.C. § 412(1)(8)(B). The parties refer to this method of expressing the Plan's level of funding as "RPA '94."

The range of interest rates used to calculate RPA '94 current liability is specified in § 1082(b)(5)(B)(ii) and § 412(b)(5)(B)(ii). The applicable interest rate must be chosen "without taking into account the experience of the plan and reasonable expectations, but consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan." 29 U.S.C. § 1082(b)(5)(B)(iii); 26 U.S.C. § 412(b)(5)(B)(iii). For 1999, the permissible range was 5.62% to 6.55%. To calculate RPA '94 current liability as of January 1, 1999, 3M's enrolled actuary selected an interest rate of 6%, which resulted in liability of $5.9 billion. The actuarial value of assets was $5.7 billion; as noted above, the market value of assets was $6.3 billion. The parties dispute whether the plan has a surplus under RPA '94.

C. The Proper Measure of Plan Funding for the Purpose of Plaintiffs' Fiduciary Duty Claim

Plaintiffs urge the Court to adopt the termination method to measure the Plan's funding.[5] Plaintiffs offer several reasons for using this method. First, they argue, a termination method is the only way to ensure with certainty that the Plan has sufficient assets to pay all accrued benefits. Second, where plan sponsors merge two or more ongoing plans or transfer assets into another existing or new plan, ERISA requires that the funding level after such merger or transfer be equal to or greater than the funding level immediately before the merger or transfer. *See* 29 U.S.C. § 1058. The plan funding level is measured in terms of benefits the plan's participants would receive as if the plan were terminating. *See id.* Accordingly, plaintiffs argue, this provision demonstrates that when plan funding and benefits security are at issue, Congress chose a termination basis as the best method for measuring funding.

While plaintiffs' arguments are not without merit, the Court concludes that the better view is that the termination method should not apply in this case. At the outset, plaintiffs do not contend that the Plan is a candidate for trusteeship under § 1342. According to the applicable regulations, therefore, it appears that the conservative interest rates plaintiffs used to calculate liability would not apply even if the Plan were terminating. *Compare* 29 C.F.R. § 4044.52

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5. As noted previously, there is no dispute that the Plan's liabilities exceed its assets when its liabilities are calculated according to the regulations applicable to plans placed under trusteeship by the PBGC. Moreover, 3M has offered no evidence that the Plan has sufficient funds to purchase annuities.

(mandating use of certain interest rates for plans placed into trusteeship) *with* § 4044.73 (mandating use of "reasonable actuarial assumptions" in calculating value of lump sum distribution for non-trusteed plans).

More importantly, there is no indication whatsoever that 3M intends to terminate the Plan. Plaintiffs cite a number of cases for the proposition that the fact of a surplus can only be determined through hindsight. *See, e.g., Shepley v. New Coleman Holdings, Inc.*, 174 F.3d 65, 70 (2d Cir. 1999). As the discussion in *Hughes* makes clear, however, ongoing plans may also have a surplus. In *Hughes*, the Court noted that where defined benefit plans are overfunded, the employer may reduce or suspend its contributions. *See Hughes*, 525 U.S. at 440. As such, " 'the employer's contribution is adjusted to whatever level is necessary' to provide the defined benefits." *Id.* (quoting *Nachman Corp. v.* PBGC, 446 U.S. 359, 363 n.5 (1980)). While the Court did not discuss the applicable measurement method, the clear implication is that the level of funding "necessary" to provide the defined benefits is that level at which the employer may reduce or suspend its contributions. Plaintiffs point out that the parties in *Hughes* did not dispute the fact of a surplus, and thus the Court had no occasion to examine how to measure it. It is clear, however, that a surplus should be measured considering not only the assets contributed to the Plan, but also any investment growth that the Plan may experience. *See Hughes*, 525 U.S. at 436 (noting that the plan's assets exceeded its liabilities "as a result of employer and employee contributions and investment growth"); *cf. Shepley*, 174 F.3d at 70 (citing *Hughes* in construing "overpayment" to include not only the payments contributed to the plan but also

investment growth as a result of those payments). In the case of ongoing plans such as 3M's, therefore, a proper measure of plan funding takes into account the plan's expected future returns on its investments. While there may be cases in which chronically underfunded plans, or plans in danger of terminating, should be evaluated using ERISA's termination methodology, this is not such a case. 3M has not had to make any required contribution to the Plan since 1993, and its rate of return over the last ten years has been over 14%. Moreover, the Plan has never missed a payment to a beneficiary, and, as noted, the Plan is not a candidate for termination, nor is there any evidence that 3M intends to terminate the Plan. Simply put, where a plan is ongoing and otherwise healthy, ERISA does not require plans to maintain funding at termination levels, a fact that the Supreme Court implicitly recognized in *Hughes*. Indeed, the Court questions whether any plan could meet this standard. Accordingly, the Court rejects plaintiffs' assertion that a termination method of measurement should be used to evaluate the funding level of an ongoing, healthy plan.

3M, for its part, urges the Court to adopt the FAS 35 method. 3M contends that FAS 35 is the most appropriate measure of the Plan's funding level because it was the method used in *Hughes* to calculate the surplus, it is the method Congress mandates that plan sponsors use in filing audited financial statements for such plans, and it represents the most accurate measure of funding status for ongoing plans. At oral argument, plaintiffs claimed that the liability for at least one of the years at issue in *Hughes* was expressed in terms of RPA '94 liability rather than FAS 35. Regardless of the method used in *Hughes*, however, the Court concludes that

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FAS 35 is not a proper method to calculate a surplus. As noted above, the *Hughes* plaintiffs alleged the fact of a surplus in their complaint, and the district court had dismissed the case for failure to state a claim. Thus, the issue of the appropriate measure of surplus was not before the *Hughes* Court, and plaintiffs here should not be bound by the *Hughes* plaintiffs' decision to characterize their plan as having surplus funds when that decision was never challenged or reviewed.

The Court is similarly unpersuaded by 3M's argument that Congress mandated the use of FAS 35 to measure a plan's funded status. It is true that ERISA requires plan sponsors to engage an accountant to verify that its financial statements are in conformance with GAAP. *See* 29 U.S.C. § 1023(a)(3)(A). But, as plaintiffs point out, ERISA requires that actuaries have specialized training before they may perform actuarial services for ERISA plans, *see* 29 U.S.C. § 1242(a), yet the FAS 35 calculations do not need to be prepared by an ERISA-enrolled actuary. *Compare* 29 U.S.C. § 1023(a)(3) (requiring "independent qualified public accountant" to review financial statements) *with* § 1023(a)(4) (requiring an "enrolled actuary" to prepare the actuarial statement). Plan sponsors must engage the services of an ERISA-enrolled actuary to calculate their minimum required contribution. *See* 26 U.S.C. § 6059(b). The Court thus finds it unlikely that Congress would have intended GAAP to be the final word on the issue of plan funding, especially when, as plaintiffs note, FAS 35 was promulgated in 1980, six years after the passage of ERISA. Finally, the value of FAS 35 as a measure of plan funding is not universally accepted. Even 3M's own expert has written that FAS 35 "ordinarily bears no relation to the plan's funding" and "is misleading as an

indication of funding for an ongoing plan. . . ." Vincent Amoroso, *Costing and Funding Retirement Benefits*, *in* The Handbook of Employee Benefits 959, 993 (Jerry S. Rosenbloom ed., 4th ed. 1996) (Plfs.' Ex. K). Given this criticism, the Court is concerned that FAS 35 would set the bar too low, and therefore rejects FAS 35 as a proper measure of a plan's funding status.

In contrast, 3M's argument regarding AAL has more merit. 3M uses AAL to calculate its minimum required contribution; since 1994, 3M's minimum contribution has been zero. Despite this fact, 3M has nonetheless voluntarily contributed over $600 million to the Plan since 1993. Considering the Court's discussion in *Hughes*, this fact, without more, could be sufficient to establish that the plan is fully funded. *See Hughes*, 525 U.S. at 440 (noting that if a plan is "overfunded," the employer may reduce or suspend its contributions). Determining plan funding under § 1082 and § 412 does not end with the plan's calculation of its minimum required contribution, however; pursuant to the 1987 and 1994 amendments to ERISA, single-employer plans must also determine whether they are required to make deficit reduction contributions. *See* 29 U.S.C. § 1082(d); 26 U.S.C. § 412(l). Congress initially enacted this additional layer of funding due to its concern that "generally applicable funding rules were not in all cases sufficient to ensure that plans would be adequately funded." H.R. Rep. No. 103-826, pt. 1, at 209 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3773, 3981. The Court therefore cannot conclude that merely because a single-employer plan has met the "generally applicable funding rules" it is therefore fully funded within the meaning of ERISA. Accordingly, the Court turns to a consideration of the RPA '94 method.

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Plaintiffs argue that 3M's reports demonstrate that its level of funding as of January 1999, when expressed in terms relevant to the RPA '94 method, demonstrates that the Plan is 97.5% funded. This funding level translates into a shortfall of slightly less than $150 million, which is more than the amount of the loss plaintiffs allege to the Plan. 3M responds that for the purpose of calculating surplus, it should be permitted to use the highest permissible interest rate to calculate current liability, which in 1999 was 6.55%, rather than the 6% rate that it used on its reports. Alternatively, 3M argues that its current liability should be measured against the market value of its assets, which is higher than the actuarial value of its assets. Either change would push the funding level above 100%.

The Court finds it unnecessary to engage in these machinations, however, because the 100% figure is not the trigger for requiring additional funding under RPA '94. As a general rule, ERISA does not require additional funding unless the plan's funded current liability percentage falls below 90%. *See* 29 U.S.C. § 1082(d)(9)(A); 26 U.S.C. § 412(1)(9)(A). Current liability, in turn, is calculated using an interest rate that reflects rates which would be used to purchase annuities. *See* 29 U.S.C. § 1082(b)(5)(B)(iii); 26 U.S.C. § 412(b)(5)(B)(iii). As such, current liability approximates termination liability. *See* H.R. Rep. No. 103-826, pt. 1, at 210 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3773, 3982 (stating that "[t]he term 'current liability' generally means all liabilities to employees and their beneficiaries under the plan determined as if the plan terminated."). The 90% trigger for contributions in excess of the general funding requirements is designed to ensure adequate funding, but it does

not mean that any plan whose RPA '94 percentage is less than 100% should automatically be considered underfunded. The interest rates used to calculate current liability bear no relation to the Plan's experience. *See* 29 U.S.C. § 1082(b)(5)(B)(iii); 26 U.S.C. § 412(b)(5)(B)(iii). In contrast, to calculate minimum funding levels generally, actuaries take into account plan experience both for rates of return and mortality. *See* 29 U.S.C. § 1082(c)(3)(A); 26 U.S.C. § 412(c)(3)(A). The 90% threshold thus represents a compromise: it permits ongoing plans to take advantage of their expected investment gains while using termination liability as a check to ensure an adequate level of funding. So long as the Plan does not fall below that threshold, therefore, there is no contradiction in considering the Plan fully funded even though its funding level, in RPA '94 parlance, is less than 100%.

By nearly any measure, the 3M Plan is a robust, richly-funded, ongoing plan. 3M has not had to make any minimum contribution to the Plan since the year before the Granite loss, and indeed, the Granite investment is likely the most significant loss in the Plan's experience. Under these circumstances, the Court considers the 90% threshold for contributions under RPA '94 a reasonable yardstick. While this threshold allows ongoing plans to take advantage of flexibility built into in the minimum funding requirements, it also factors termination liability into the analysis and therefore curbs some of the uncertainty inherent in predicting the future. Most importantly, because it is used to flag ailing plans, it represents Congress's judgment regarding how to assess the financial strength of single-employer defined benefit plans. The Court therefore holds that for plans such as 3M's which are in financially sound condition, the 90%

threshold of RPA '94 is an appropriate measure of the plan's funded status. Because there is no dispute that the Plan's funding has exceeded the 90% threshold every year since the Granite loss,[6] the Court grants 3M's motion for summary judgment.

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6. Plaintiffs argue that because the Plan's funding changes over time, permitting the Plan's funding status to constitute a defense would allow the fact of liability to depend on the Court's schedule. In its earlier Order, the Court did not directly address the issue of the time for determining the funding status of the Plan; both parties have used January 1999 as the pertinent date. The Court notes that plaintiffs' concern could be ameliorated by setting a specific date for determining funding status, for example, the next valuation date after the alleged breach. The Court need not decide this issue, however, because the Plan's funding status has had a surplus under the RPA '94 method every year since the Granite loss; thus, 3M is entitled to summary judgment regardless of the date.

Appendix B

ORDER

Based on the submissions of the parties, the arguments of counsel and the entire file and proceedings herein, **IT IS HEREBY ORDERED** that defendant's motion for summary judgment [Docket No. 101] is **GRANTED**, and plaintiff's amended class action complaint [Docket No. 116] is **DISMISSED WITH PREJUDICE**.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: March 29, 2000.

s/ John R. Tunheim
JOHN R. TUNHEIM
United States District Judge

APPENDIX C — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA DATED AND FILED MARCH 31, 1999

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Civil No. 4-96-488 (JRT/RLE)

MEMORANDUM OPINION AND ORDER

Plaintiffs, individually and on behalf of all others similarly situated, brought this action against defendant Minnesota Mining and Manufacturing, Co. ("3M"), alleging that 3M breached its fiduciary duty under section 404(a)(1)(B) of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1104(a)(1)(B), by failing to invest prudently the assets of the 3M Employee Retirement Income Plan ("the Plan"). In an Order dated September 25, 1997, the Court certified a class of all participants and beneficiaries of the Plan ("the Class").

This matter is now before the Court on the Class's motion for partial summary judgment on the issue of liability as to its "prohibited transaction" claim, defendant's cross-motion for dismissal or summary judgment on this claim, and defendant's motion for summary judgment (seeking dismissal of this action in its entirety). For the reasons set forth below, the Class's motion is denied, 3M's cross-motion is granted, and 3M's motion for summary judgment is denied.

Appendix C

BACKGROUND

The Plan is a "defined benefit plan" subject to the terms of ERISA, 29 U.S.C. § 1001 *et seq.* As a defined benefit plan, the Plan is obligated to pay only a defined benefit to its participants upon retirement. It is a massive entity, encompassing thousands of participants and beneficiaries and containing total assets in excess of $4 billion.

It is undisputed that 3M is a fiduciary of the Plan and is responsible for overseeing the investment of Plan assets. 3M delegated this responsibility to its "Pension Asset Committee" ("the PAC"). 3M also has a staff dedicated to overseeing fund investments and assets. In 1990, members of the PAC decided to invest $20 million in Plan assets in Granite Corporation ("Granite" or "the fund"), a "hedge fund" containing collateralized mortgage obligations ("CMOs").[1]

Tony Estep, Granite's investment manager at the time 3M was first exploring an investment in Granite, initially met with 3M staff and gave the staff certain marketing materials about the fund. These materials stated that Granite's strategy would produce very high returns while investing in "low risk instruments." These materials also indicated the fund would maintain a "market neutral" strategy. However,

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1. CMOs are mortgage-backed bonds that are divided and repackaged in a way to appeal to investors who want more or less risk than the original underlying securities. These subdivisions are also known as "tranches." Some tranches, particularly those representing more junior positions, carry substantial risks. Two important, somewhat interrelated risks associated with CMOs are interest rate risk and mortgage borrower prepayment behavior.

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Granite's 1990 Private Placement Memorandum ("PPM"), which 3M received shortly after the initial meeting with Estep, made clear that the investment faced substantial risks, including interest rate risks, potential difficulties in predicting market movements, possible illiquidity, and the risk of proportionally greater losses due to the use of leveraging. Moreover, the PPM disclosed that the fund's strategy may depend on the investment manager's ability to predict market movements and that there could be no assurance that a market neutral position could be achieved.

3M contends, without specification, that it made this investment after almost a year of its own investigation and analysis of the Granite strategy. The Class notes, however, that after Deborah Weiss, 3M's Manager of Pension Investments, recommended the Granite investment to the PAC, the PAC voted to make the investment after a brief (ten to twenty minute) discussion.[2] The Class further claims it was naive for Weiss and the PAC to accept Granite's representations that it could earn a very high, fixed rate of return while investing in low risk instruments. As set forth above, these representations were in conflict with the warnings of risk in the PPM, which only Weiss and 3M's ERISA counsel read. Moreover, Weiss had received information from other fixed-income investment managers suggesting that CMOs may have illiquidity problems, may be difficult to analyze, and may face substantial fluctuations in returns based on changes in prepayments. Yet no member of Weiss's staff or the PAC conducted a thorough, independent analysis of the risks associated with Granite's

2. Likewise, several meeting participants could not recall whether they discussed CMOs or Granite's strategy at the meeting.

investment strategy. Likewise, although Weiss understood that the CMO market may be "thinly traded," neither she nor other staff or PAC members undertook an investigation to determine whether Granite's valuations were valid or to unearth the risks associated with a potentially illiquid market.[3]

Weiss had limited exposure to CMOs prior to recommending the investment to the PAC. She also never conducted a background check on Estep, who, it turns out, did not have much experience with CMOs before starting Granite. It also appears undisputed that no member of the PAC committee or the Plan's staff who participated in the decision to invest in Granite had expertise in evaluating or investing in CMOs.[4] In fact, several members testified that they did not understand information Granite had given to them about the securities it was purchasing. Despite the PAC members' lack of expertise, at no time — before investing or during the period the Plan was invested in Granite — did 3M hire an "outside advisor" (in addition to Granite's managers) to evaluate the Granite investment or Granite's strategy.

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3. The interaction between interest rates and mortgage prepayments can make the valuation of CMOs highly difficult and complex. In addition, the Class notes that, at certain times, there may be no ready market for CMOs.

4. Apparently, one member of the Plan's staff had attended a seminar regarding CMOs prior to 3M's decision to invest, but had no experience in investing in these instruments at that time. She later did invest in and analyze CMOs as part of her work for the plan, but she did not share what she had learned with other PAC members and staff. Also, the staff had some exposure to more senior CMO tranches as a result of an earlier Plan investment.

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After Estep resigned in 1991, David Askin took over as investment manager of Granite. The Class contends that withdrawal from Granite would have been appropriate at this point because Granite's returns had been far below the projected, "stable" high returns set forth in the marketing materials. Shortly thereafter, Askin formed Askin Capital Management ("ACM"), which served as Granite's investment manager throughout the rest of the relevant period. 3M personnel undertook minimal investigation of the impact on Granite from Estep's withdrawal and no investigation of Askin's experience. Weiss did talk to three other institutional investors in the fund: two chose to remain, and one decided to divest. She also interviewed Askin, but does not recall discussing his experience. Askin in fact had little previous experience managing and trading CMOs. According to the Class, this perfunctory review of Askin contradicted 3M's own stated policy of reviewing anew an investment in a fund with a new investment manager.

In implementing the Granite strategy, ACM was to purchase different and often volatile classes of CMOs which would respond to interest rate movements in various ways. At least in theory, these purchases were supposed to ensure that Granite remained market neutral and maintained a stable value despite changes in interest rates. ACM's application of the strategy also involved a high degree of leverage; in other words, the fund purchased CMOs on margin substantially in excess to investor equity to boost return. Despite its low returns under Estep, 3M's investment in Granite generated a 68.5% return prior to the market collapse in March 1994.

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3M left to Granite's investment managers the task of implementing the Granite strategy.[5] 3M personnel therefore did not participate in the decisions regarding the selection of Granite's securities. In essence, 3M selected Granite's investment managers to implement Granite's strategy and relied on these managers once these Plan had invested.

Weiss and other staff members received periodic reports from ACM and would monitor Granite's returns.[6] However, 3M personnel never conducted their own, independent analysis of Granite's risk position or strategy at any time during the investment.[7] They also never evaluated whether

5. It is undisputed that, as to the assets invested in Granite, ACM also was appointed as an investment manager of assets of the Plan under § 1102(c)(3) of ERISA.

6. The Class's ERISA expert, Jeffrey Clayton, concluded that 3M's actions in overseeing the Granite investment did not comport with its fiduciary obligations. In his report, Clayton stated as follows:

> Because the [Granite] investment involved complex, illiquid and volatile financial instruments and because the strategy was novel and unproven, the Plan fiduciaries had a heightened responsibility to discover and understand how the investment was performing and whether the stated strategy and methodology was being followed by the manager.

7. Weiss was aware during this period that some sophisticated CMO investors had experienced significant losses. Also, another staff person had noticed at one point that Granite's leverage position was as high as seven to one, but he made no report of this nor conducted any further investigation.

ACM's valuations were accurate, whether its strategy had changed over time, or whether — given fluctuations in the market and other circumstances — the risks of the fund's investments had changed. In fact, Weiss and her assistant testified that 3M did not have sufficient staff to closely monitor Granite.

Both the 1990 and 1993 PPMs provided that the Plan would compensate Granite's managers through a performance-based "incentive" fee equal to fifteen percent of any increase in value in excess of the London Interbank Offered Rate ("LIBOR"). The Plan was to pay these fees annually, on the anniversary date of its investment, based on performance during the preceding twelve months. Both PPMs also indicated that the payment of these fees created an "inherent or potential" conflict of interest.[8] 3M only paid incentive fees to ACM once, on March 31, 1993, in the amount of approximately $1.1 million. 3M offers the opinion of one of its investment experts that this fee was reasonable compensation for ACM's services.

Following a significant and, according to 3M, unprecedented rise in interest rates in February and March 1994, the CMO market and Granite in particular experienced

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8. For example, the 1990 PPM stated in part:

> Because the Adviser's compensation increases with an increase in Net Gains, this arrangement may create an incentive for the Adviser to make more speculative investments on behalf of the Fund than it would otherwise make if it received compensation unrelated to the investment performance of the Fund.

significant difficulties. As interest rates rose, the value of the CMOs owned by Granite dropped dramatically. To make matters worse, brokerage firms began demanding additional money from Granite to serve as margin for the leveraged CMOs Granite held. Because Granite was severely leveraged by this point, it collapsed and ultimately was liquidated. 3M wrote off the investment in its entirety.

During the investigation and litigation that followed Granite's downfall, it was revealed that Wall Street securities dealers had colluded wrongfully to foreclose on the loans they had made to the fund. In addition, Askin admitted to investors that he had inflated improperly the value of Granite's portfolio in February 1994. It also became obvious that ACM had failed to implement the purported strategy of remaining market neutral. In May 1994, Weiss told the PAC that the prices of CMOs had been theoretical and that CMO brokers and Askin would negotiate a price and the brokers would provide confirmation to satisfy auditors.[9]

The parties dispute whether, given the information available prior to the collapse in 1994, prudent fiduciaries would have invested in Granite. 3M provides the opinion of three of its experts to support its contention that its investment in Granite was appropriate. 3M also points out that approximately ninety sophisticated investors besides 3M chose to invest in Granite. In addition to its other evidence, the Class offers an expert opinions that 3M failed to discharge its fiduciary duties in investigating and monitoring the Granite investment. According to one of the Class's experts,

9. Certain members of the PAC later testified that they were not aware, prior to Granite's collapse, of ACM's use of leverage.

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3M's failure to investigate and monitor the investment led to its failing to act upon obvious and numerous "red flags," warning of existing and increasing investment risks.

The Class contends that the total depletion of plan assets resulting from Granite's demise is approximately $80 million. 3M does not quarrel specifically with this figure, but instead notes that the Granite investment accounted for less than one percent of the Plan's assets. Moreover, despite the loss, the Plan has never failed to make any payments it owes to its participants and beneficiaries. Also, taking the Granite loss into account, the Plan's portfolio prospered during this period and achieved its goals and all internal benchmarks. In fact, on a portfolio-wide basis, the Plan outperformed ninety-five percent of its peer group of investment funds over the life of the Granite investment.

Furthermore, 3M contends that the Granite investment caused the Plan no harm because it operated at a surplus during the entire period. According to David E. Delahanty, 3M's actuarial expert, the Plan had a surplus in excess of $300 million at the time the Granite loss was realized, and that surplus now had grown to just under $500 million. Also, it appears undisputed that 3M contributed "voluntarily" over $500 million to the Plan between 1990 and 1996, a figure which represents payments in excess of the contributions the Internal Revenue Code ("IRC") requires.[10]

The Class offers no expert testimony in response. Instead, Class counsel challenged Delahanty's assumptions during his

10. 3M contributed over $400 million of this amount after Granite's meltdown.

deposition. Delahanty admitted that his assessment of the Plan's financial condition was based on projections that were far less conservative than, for example, those mandated in the Omnibus Budget Reconciliation Act of 1987 ("the OBRA") and the Retirement Projection Act of 1994 ("the RPA"). Moreover, the Class notes that if the Plan were terminated, an even more conservative set of assumptions would be applicable. Under these accounting methods, the Plan was underfunded, at least as of January 1, 1996.

In an affidavit submitted with 3M's reply memorandum, Delahanty contends that his method for calculating the financial condition of the Plan is actuarially sound. He also states that the methods employed by class counsel — including those based on the OBRA and the RPA — are premised on artificially low rates of return. His analysis, on the contrary, is based on an assumed rate of return that is higher, but reflects (conservatively) the Plan's actual rate of return over the past twenty years. Thus, according to Delahanty, his calculations more accurately reflect the Plan's funding status.

STANDARD OF REVIEW

Rule 56 of the Federal Rules of Civil Procedure governs motions for summary judgment, stating in pertinent part:

> [Summary] judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no

> genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. P. 56(c). Summary judgment is to be granted only where the evidence is such that no reasonable jury could return a verdict for the non- moving party. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986).

Initially, the movant bears the burden of bringing forward sufficient evidence to establish that there are no genuine issues of material fact and that the movant is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). In evaluating the movant's showing, the evidence offered by the non-moving party is to be believed and all justifiable inferences therefrom are to be drawn in the light most favorable to that party. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). Where a moving party makes and supports a motion for summary judgment in accordance with Rule 56, a party opposing the motion may not rest upon the allegations or denials of its pleadings; rather, the nonmovant must "set forth specific facts showing that there is a genuine issue for trial." *Liberty Lobby*, 477 U.S. at 256; *Krenik v. County of Le Sueur*, 47 F.3d 953, 957 (8th Cir. 1995). Accordingly, the nonmovant "must make a sufficient showing on every essential element of its case for which it has the burden of proof at trial." *Wilson v. Southwestern Bell Tel. Co.*, 55 F.3d 399, 405 (8th Cir. 1995).

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ANALYSIS

The Class claims that 3M breached its fiduciary duty to act prudently under § 1104(a)(1)(B) by investing Plan assets in Granite without thoroughly investigating, monitoring, and understanding all aspects of the Granite investment. In addition, the Class claims that 3M breached its fiduciary duty under this section by making and maintaining the investment under circumstances which clearly presented a prohibited transaction under § 1106(b)(1). The Class moves for partial summary judgment as to liability on the latter theory.

3M moves for dismissal or summary judgment on both theories. It first argues that the Class has failed to establish a breach of any fiduciary duty under ERISA. In addition, 3M argues that the alleged breach caused none of the Granite losses and that the Class has suffered no harm as a result of any such breach. As to the Class's "prohibited transaction" claim in particular, 3M contends it is entitled to dismissal or summary judgment because the Class failed to plead this claim and cannot establish that ERISA prohibits the Granite investment.

ERISA imposes on benefit plan fiduciaries a strict standard of care:

> [A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man

> acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. . . .

29 U.S.C. § 1104(a)(1)(B). Under § 1109(a), a fiduciary who breaches the aforementioned duty "shall be personally liable to make good to such plan any losses to the plan resulting from each said breach."

A breach of fiduciary duty claim under ERISA involves a three-step analysis. *See, e.g., Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917 (8th Cir.1994) (citing *Martin v. Feilen*, 965 F.2d 660, 671 (8th Cir. 1992), *cert. denied*, 506 U.S. 1054 (1993)). First, the Class bears the burden of proving a breach of fiduciary duty. *See id.* The Class must also prove a prima facie case of loss to the Plan. *See id.* Once the Class has satisfied these burdens, the burden of persuasion shifts "to the fiduciary to prove that the loss was not caused by . . . the breach of duty." *Id.* (quoting *Martin*, 965 F.2d at 671).

3M argues that *Martin* and its progeny do not stand for the proposition that it bears the burden of proof on the issue of causation. To support this contention, it relies principally on the concurring opinion in a Second Circuit decision, *see Silverman v. Mutual Benefit Life Ins. Co.*, 138 F.3d 98, 106 n.1 (2nd Cir.) (Jacobs, J., concurring), *cert. denied*, 119 S.Ct. 178 (1998), in which two members of that court viewed the issue in *Martin* as relating merely to the calculation of damages. This Court disagrees with this reading of *Martin*. *Martin* and its progeny provide that, in an ERISA breach of fiduciary duty case, the defendant bears the burden on the

issue of causation once the plaintiff proves a breach and provides evidence of a loss to the plan.[11] *See Roth*, 16 F.3d at 917; *Martin*, 965 F.2d at 671; *see also Felber v. Estate of Regan*, 117 F.3d 1084, 108-88 (8th Cir. 1997) (going out of its way to point out to future litigants *Martin*'s burden-shifting framework). Moreover, the *Martin* court noted that it would not "take kindly to arguments by fiduciaries who have breached their obligations that, if they had not done this, everything would be the same." 965 F.2d at 671-72 (quoting *In re Beck Indus.*, 605 F.2d 624, 636 (2nd Cir. 1979)). While the Second Circuit now may hold otherwise, in this circuit, the defendant bears the burden on this issue. The Court will address separately the elements of breach (for both the Class's general claim and its "prohibited transaction" theory), loss, and causation.

I. Breach of Fiduciary Duty

A. The Class's General Standard of Care Claim

The Class contends that 3M breached its duty to act as a prudent fiduciary by failing to conduct an independent and thorough investigation of the Granite investment, including

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11. In *Roth*, 16 F.3d at 917 the Eighth Circuit described how an ERISA defendant can prevail at the summary judgment stage in light of this allocation of trial burdens:

> As the party moving for summary judgment, however, the trustees can prevail only by demonstrating the absence of a genuine issue of material fact either on the elements of the claim for which the plaintiffs bear the burden of persuasion at trial or on the elements for which the trustees themselves bear the burden of persuasion at trial.

failing to acquire sufficient understanding about CMOs and Granite's strategy before investing. Also, the Class claims that the Plan's staff and PAC members lacked the capabilities to monitor the ongoing Granite investment, failed to take adequate steps to oversee the investment, and failed to conduct a proper analysis of whether to remain invested in Granite when ACM took over as the investment manager.

3M argues that the Class has mischaracterized the appropriate standard of care and has offered insufficient evidence to establish breach under the appropriate standard. Specifically, 3M argues that the Class erroneously insists that ERISA requires fiduciaries to be "prudent experts," that fiduciaries cannot rely on the expertise of a carefully chosen investment manager, and that the Granite investment should be evaluated in a vacuum rather than in the context of the Plan's entire portfolio. 3M also contends that the Class's claim fails because it has not shown that further diligence would have revealed that the investment was inappropriate.

The Court finds that genuine issues of material fact preclude summary judgment on the issue of breach. The "prudent person" standard articulated in § 1104(a)(1)(B) is objective, focusing on the fiduciary's conduct preceding or at the time of the challenged conduct. *See Roth*, 16 F.3d at 917-18. Under this standard, a fiduciary is obligated to undertake an independent investigation of the merits of an investment and to use appropriate, prudent methods in conducting the investigation. *See, e.g., In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 435 (3d Cir.) ("[T]he most basic of ERISA's investment fiduciary duties [is] the duty to conduct an independent investigation into the merits of a particular

investment."), *cert. denied*, 510 U.S. 810 (1996); *Liss v. Smith*, 991 F. Supp. 278, 297 (S.D.N.Y. 1998) (stating that the failure to make an independent investigation and evaluation has "repeatedly been held to constitute a breach of fiduciary obligations") (citing cases); *Whitfield v. Cohen*, 682 F. Supp. 188, 194 (S.D.N.Y. 1988) (stating that the "test of prudence focuses on the trustee's conduct in investigating, evaluating and making the investment," and indicating that the trustee's failure to make an independent investigation is a breach of fiduciary duty) (citing *Fink v. National Sav. and Trust Co.*, 772 F.2d 951, 957 (D.C. Cir. 1985)). Once the investment is made, a fiduciary has an ongoing duty to monitor investments with reasonable diligence and remove plan assets from an investment that is improper. *See, e.g., Liss*, 991 F. Supp. at 299 (noting, in finding a breach of fiduciary duty, that the fiduciaries had failed to monitor the performance of the fund's broker); *Hunt v. Magnell*, 758 F. Supp. 1292, 1299 (D. Minn. 1991) ("ERISA fiduciaries must monitor investments with reasonable diligence and dispose of investments which are improper to keep."); *Whitfield*, 682 F. Supp. at 196. Typically, whether a fiduciary acted prudently — or in other words, as a reasonably prudent fiduciary — is a question of fact. *See, e.g., Roth*, 16 F.3d at 919 (finding that whether the fiduciaries acted reasonably in the circumstances presented involved a question of fact precluding summary judgment).

Viewing the facts in a light most favorable to the Class, a reasonable fact finder could conclude that 3M's investigatory and monitoring methods and actions were below ERISA's standard of reasonable care. At the time 3M chose to invest in Granite, no staff person or PAC member had expertise or

experience in evaluating or investing in CMOs. The Court agrees with 3M that ERISA does not impose a rule that fiduciaries be "experts" on all types of investments they make. However, if a fiduciary lacks the education, experience, or skills to be able to conduct a reasonable, independent investigation and evaluation of the risks and other characteristics of the proposed investment, it must seek independent advice. *See, e.g., Liss*, 991 F. Supp. at 297 (citing cases and stated that "where the trustees lack the requisite knowledge, experience and expertise to make the necessary decisions with respect to investments, their fiduciary obligations require them to hire independent professional advisors"); *Whitfield*, 682 F. Supp. at 194 (citing *Donovan v. Bierwirth*, 680 F.2d 263, 272-73 (2nd Cir.), *cert. denied*, 459 U.S. 1069 (1982)); *see also* § 1104(a)(1)(B) (requiring fiduciaries to act with "the care, *skill*, prudence and diligence that a prudent man acting in a like capacity and familiar with such matters would use") (emphasis added). Here, while Weiss received some feedback on CMOs from various investment advisors, neither she nor others at 3M sought out advice from knowledgeable sources on the risks associated with Granite's investment in CMOs or the fund's overall strategy.[12] *Cf. Restatement (Third) of Trusts* § 227 cmt. n (1992) (stating that, for investments in mortgage-

12. Indeed, some of the feedback Weiss received should have raised red flags, since a number of the comments suggested that CMOs can be subject to prepayment and liquidity risks and may be difficult to analyze. A fact finder could conclude that such information would have led a prudent fiduciary — who is not an expert on CMOs — to conduct additional investigation or seek out particularized expert advice.

backed securities, trustees "have a duty to exercise the care and skill necessary to understand [the securities'] risks and other characteristics").

Moreover, there is a fact dispute whether 3M personnel, on their own, conducted a sufficient investigation of the Granite investment and undertook sufficient deliberation of the fund's characteristics before deciding to invest. The staff's inquiries regarding CMOs were limited, and many PAC members quickly approved the investment without reading the PPM or seeking out other information. The failure of staff and PAC members to undertake a more critical analysis is particularly troubling in light of the apparent conflict between representations regarding risk in Granite's marketing materials and the significant risks and other factors outlined in the PPM. 3M therefore may have breached its fiduciary duty in failing to conduct an sufficient investigation prior to investing.

Likewise, the Class has raised a fact dispute with regard to whether it undertook reasonably prudent efforts to monitor the investment. 3M points out that it retained Granite's investment managers as the "experts" to oversee this investment. It contends that it did not need hire a "second expert" to oversee these managers. While the Court agrees that ERISA does not impose a *per se* "second expert" requirement, in the circumstances of this case, a fact finder could conclude that resort to some kind of outside assistance would have been necessary to satisfy 3M's duty of reasonable prudence. Certainly, ERISA does not require a plan fiduciary to hire an additional, outside person to second-guess each investment decision the retained investment manager makes.

Yet after 3M appointed Granite's managers to oversee the Granite investment, 3M still had an obligation to supervise and monitor that investment.[13] When viewed in its most

13. Because it delegated to Granite's managers the fiduciary duty to administer the Plan's assets according to agreed upon terms relating to that investment, 3M is not subject to liability for acts or omissions of the managers that contravene those terms. *See, e.g.*, 29 U.S.C. § 1105(d)(1); *Harris Trust and Sav. Bank v. Salomon Bros., Inc.*, 832 F. Supp. 1169, 1177 (N.D. Ill. 1993) ("Section [1102(c)(3)] authorizes a named fiduciary to appoint an investment manager to administer the assets of a pension trust fund, while under [§ 1105(d)(1)], a trustee is not responsible for an appointed investment manager's acts or omissions"). This does not relieve 3M of its oversight responsibilities, however. 3M hired Granite's managers to implement the Granite strategy; whether that strategy was prudent throughout the relevant period remains within 3M's domain of responsibility. *Cf. Whitfield*, 682 F. Supp. at 196 (stating that a plan trustee had a duty to monitor an investment with reasonable diligence and withdraw the investment if it was no longer proper for the plan). As such, 3M had a duty to monitor the investment to ensure that it remains a prudent investment for the plan. *See id.*; *see also Harris*, 832 F. Supp. at 1178 ("Because ERISA finds fiduciary duties where there is actual authority, and because a trustee can retain some control over a pension trust's assets despite delegation of authority to an investment manager, it is possible that [the trustee] retained and exercised actual control over the disposition of [the fund's] assets such that it owed the fund a fiduciary duty of care.").

In addition, 3M was obligated to conduct an evaluation of Askin (and ACM) when he took over as Granite's investment manager. *See, e.g.*, *Whitfield*, (suggesting that ERISA requires, among other things, evaluation of an investment manager's experience and credentials). There is a fact dispute whether 3M properly evaluated its continuing investment in Granite when Askin became the

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favorable light, the Class's evidence shows that 3M personnel simply were unable to monitor the Granite investment effectively: they did not have sufficient staff or expertise to analyze fully Granite's periodic reports or the securities Granite held, to perform stress tests on the risks associated with the fund's strategy, and to evaluate whether ACM was managing Granite appropriately or whether there were changes in fund's strategy. Because its lack of skill and resources arguably rendered 3M's monitoring efforts virtually useless, the Court believes that prudence may have required 3M to seek out assistance in monitoring the Granite investment.[14]

(Cont'd)
investment manager because the staff and PAC may have failed to undertake a reasonable investigation of Askin's (and ACM's) credentials and expertise. This calls into doubt 3M's contention that they delegated investment management responsibilities to a "carefully selected" investment manager.

14. Moreover, 3M's allegedly blind reliance on Granite's investment managers is particularly troubling given that the managers' livelihood was derived from the success of the investments. Although these managers were plan fiduciaries, the Court believes that a fact finder could conclude that this compensation structure required 3M to take even greater care in understanding, evaluating, and monitoring the overall investment strategy. *Cf. Liss*, 991 F. Supp. at 299 (finding that plan fiduciaries had breached their duty by blindly relying on the recommendations and strategies of a broker whose livelihood was derived from commissions). This is particularly true since Granite's managers openly disclosed in the PPMs that they had a potential and inherent conflict of interest that could create an incentive to invest in more speculative investments.

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3M also argues that the Class's claim inappropriately focuses on the Granite investment alone, without viewing it as part of the overall strategy for the 3M Plan. 3M argues that this investment was merely part of a prudent overall strategy and that the entire portfolio undisputedly outperformed the vast majority of the funds in its peer group. The Court rejects this argument in this context. The Class is not contending merely that 3M violated its fiduciary duties by choosing (knowingly) to make an investment that involved some risk or other characteristic. If that were the Class's theory, an analysis of whether the investment chosen was prudent would be dependent on an evaluation of how it fit into the larger portfolio strategy, including how it counterbalanced other risks in the portfolio. Rather, the Court interprets the Class's claim to be that, by failing to properly investigate, understand, and monitor the Granite investment, 3M unknowingly made and maintained an investment posing severe risks that a prudent fiduciary would not have tolerated in the Plan's portfolio. While it is important to look at the structure of the entire portfolio to determine whether stated objectives with regard to a particular investment are sound, how the remainder of the portfolio performed is not determinative, where, as here, the particular investment allegedly contains unplanned and unacceptable risks within (or regardless of) the overall portfolio objectives.[15] Again, the Court finds fact disputes preclude summary judgment on the issue of whether a prudent fiduciary in 3M's position would have made and maintained the Granite investment.

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15. The Department of Labor regulation on which 3M relies therefore is inapposite because it simply counsels against judging investments with a certain level of anticipated risk to be *per se* imprudent, without addressing the role these investments play in the overall portfolio strategy. *See* 44 Fed. Reg. 37,221, 37,222 (1979).

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Finally, 3M asserts that the Class has failed to demonstrate a breach of duty because there is no evidence that 3M personnel would have discovered additional information had they taken further steps. *See, e.g., Kuper v. Iovenko*, 66 F.3d 1447, 1460 (6th Cir. 1995) (stating that a plaintiff must show that an adequate investigation would have revealed that the investment at issue was improvident); *see also Unisys*, 74 F.3d at 436 (stating that "the thoroughness of a fiduciary's investigation is measured not only by the actions it took in performing it, but by facts that an adequate investigation would have uncovered"). The Court finds that there are sufficient facts in the record to preclude summary judgment on this basis. The Class has offered evidence that many staff and PAC members mistakenly thought Granite was a low-risk investment, did not understand the risks associated with CMOs and the CMO market, did not know that Granite was highly leveraged, did not know that Granite's managers lacked experience with CMOs, were not aware of potential illiquidity problems, were not able to appreciate the nature of Granite's strategy, and did not realize or understand the changes over time in Granite's leverage and hedge position. Moreover, the differences between the risk disclosures in the marketing materials and the PPMs, Granite's change in investment managers, and the structure of ACM's compensation, all were factors about which 3M decision makers should have known and deliberated. Had the staff and PAC undertaken adequate investigation, deliberation, and monitoring activities, they all would have learned of these risks and other circumstances, and factored them into the decision of whether to make or maintain the investment. A fact finder could conclude that a reasonably prudent fiduciary, armed with all of this information, would

have determined that the Granite investment contained significant risks and unknown dangers, and therefore was improvident.

B. The Class's "Prohibited Transaction" Claim

In addition to its general duty of care claim under § 1104(a)(1)(b), the Class offers a separate theory of breach. It claims that 3M should have known, based on the PPMs and even minimal investigation, that ACM had the ability to influence the prices of CMOs in the "thinly traded" CMO market and affect its incentive-based compensation. The Class contends that this constituted a *per se* forbidden use of Plan assets — under § 1106(b)(1) — by ACM to benefit its own compensation. According to the Class's theory, 3M thereby breached its fiduciary duty under § 1104 in making and maintaining the investment under circumstances which presented a clear prohibited-transaction.

3M's response is multi-layered. It first argues the claim should be dismissed under Rule 8(a)(2) of the Federal Rules of Civil Procedure ("Rule 8(a)(2)"), because the Class failed to include this claim in the Amended Complaint and otherwise has not given 3M proper notice of it. 3M also contends that "reasonable compensation [to fiduciaries] for services rendered" are exempted from 1106(b)'s prohibited transaction rules under § 1108(c)(2) and that the fees it paid to ACM were reasonable. Finally, 3M makes a number of other arguments why — even if ACM engaged in a prohibited transaction — 3M did not violate its duty to act diligently and prudently.

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The Court finds that 3M is entitled to summary judgment on this claim. As an initial matter, 3M's contention that the Class did not give it proper notice of this claim is not without merit. Although the Class set forth general allegations regarding 3M's breach of its fiduciary obligations under § 1104(a)(1)(B) (some of which relate to compensation and securities valuation issues), the Amended Complaint does not contain a "short plain statement" indicating that the Class was seeking relief under this "prohibited transaction" theory. *See* Rule 8(a)(2) (requiring that the pleader set forth in the pleading "a short and plain statement of the claim showing that the pleader is entitled to relief"). In fact, the Amended Complaint does not refer at all to prohibited transactions. Also, while the Class is able to cite to evidence in the record that relates to or supports its prohibited transaction claim, it cites to nothing that suggests 3M was actually on notice that the Class would be proceeding under this theory. Moreover, the fact that the Class's theory has changed since it filed its motion for partial summary judgment — the claim initially was that the compensation structure violated § 1106(a) rather than § 1106(b)(1) — provides further support for 3M's contention that it has had to confront a moving target.

Nevertheless, even assuming 3M had sufficient notice of this theory such that it is not prejudiced by the Class's failure to plead it more plainly, the Court finds that 3M is entitled to summary judgment because there is no evidence in the record to support the claim. Section 1106(b)(1) prohibits a plan fiduciary from "deal[ing] with assets of the plan in his own interest or for his own account." However, § 1108(c) provides in relevant part:

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Fiduciary benefits and compensation not prohibited by section 1106
Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from —

(2) receiving any reasonable compensation for services rendered . . . except that no person so serving who already receives full-time pay . . . shall receive compensation from such plan. . . .

Although the Class argues that Labor Department regulations and case law make clear that § 1108's exemptions do not apply to alleged violations under § 1106(b), these cited authorities only preclude application of § 1108(b) exemptions. *See* 29 C.F.R. § 2550.408b-2(e)(1) ("If the furnishing of office space or a service involves an act described in [§ 1106(b)], such an act constitutes a separate transaction which is not exempt under [§ 1108(b)(2)]."); *Daniels v. National Employee Benefit Servs., Inc.*, 858 F. Supp. 684, 693 (N.D. Ohio 1994) (addressing whether the exemption set forth in § 1108(b)(2) applies in the § 1106(b) context and relying on 29 C.F.R. § 2550.408b-2(e)(1)); *Lowen v. Tower Asset Management, Inc.*, 653 F. Supp. 1542, 1554-55 (S.D.N.Y.), *aff'd*, 829 F.2d 1209 (2nd Cir.1987) (finding a § 1108(b) exemption to be inapplicable to § 1106(b) violations but finding the § 1106(c)(2) to be inapposite in the circumstances for other reasons). None of these authorities suggests that § 1108(c)(2)'s exemption is inapplicable. *Cf. Lowen v. Tower Asset Management, Inc.*, 829 F.2d 1209, 1216 (2nd Cir. 1987) ("Section [1108(c)(2)] provides that [§ 1106] shall not be construed to prohibit any fiduciary from 'receiving any reasonable compensation for

services rendered. . . .' "). Absent clear and authoritative direction to the contrary, the Court will not ignore the plain language of the statute. Thus, ACM's incentive-based compensation structure only constituted a "prohibited transaction" under ERISA if ACM received more than "reasonable compensation for services rendered."[16]

The Court finds that the Class has presented no evidence that ACM's compensation was unreasonable. ACM was compensated by the Plan only once, in March of 1993. Although the Class has offered evidence that ACM had the ability to negotiate prices and valuations of CMOs with dealers and evidence that, in 1994, it artificially inflated the value of the securities it held, there is no evidence that the March 1993 payment was the result of any inflationary tactics. In addition, nothing in the record suggests that the amount ACM actually received — approximately $1.1 million — was unreasonable compensation for the services it had rendered during the relevant period. On the contrary, 3M offers the only evidence on this matter, an expert opinion that this amount was reasonable.

Obviously then, there can be no finding that, through greater diligence and investigation at the time, 3M personnel would have discovered that ACM was charging unreasonable fees.[17] That 3M personnel knew or should have known that

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16. It is undisputed that ACM received no payment from the 3M plan other than this compensation. Thus, it is not excluded from the § 1108(c)(2) exemption on account of receiving other "full-time pay."

17. The Class notes that Weiss had some concern about Granite's fees prior to making the investment. However, there is no evidence

(Cont'd)

ACM had the ability to manipulate prices and charge unreasonable fees is not enough; the Class must demonstrate that 3M should have discovered that ACM actually caused the Plan to pay fees in excess of that to which it was entitled. *Cf. Acosta v. Pacific Enters.*, 950 F.2d 611, 621 (9th Cir. 1991) (affirming the dismissal of a § 1106(b)(1) claim and stating that "[a]ll fiduciaries have the inherent power that would enable them to deal with assets of ERISA plans for their own benefit or account. . . . [but] we know of no rule that permits a plaintiff to bootstrap a claim for the actual commission of a wrong merely by alleging that the defendant had the power to commit it").

Thus, the Class's prohibited transaction claim must be dismissed because there are no facts from which a finder of fact could conclude that 3M breached its duty of care.[18] 3M's

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that she had a concern that its fees were unreasonable, that she had any reason to believe the fees actually paid were unreasonable, or that she knew or should have known that ACM ultimately would manipulate prices. Moreover, while it is clear in hindsight that Askin manipulated prices — at least in 1994 — there is no evidence to suggest that 3M could have discovered any manipulation even if it had conducted a thorough investigation prior to the Plan's 1993 payment.

18. The Court notes that ACM's compensation structure and the warnings in Granite's PPMs regarding the conflict of interest this structure creates still are relevant to the Class's surviving claim. As discussed previously, the presence of this type of compensation arrangement may have led a prudent fiduciary to second-guess the Granite investment and to monitor more closely ACM's valuations and strategy.

cross-motion for summary judgment on this claim therefore is granted, and the Class's motion for partial summary judgment is denied.

II. Losses to the Plan

The Class claims that 3M must compensate the Plan for losses of approximately $80 million resulting from the Granite investment. 3M responds that, despite the total loss of the investment, the Plan has suffered no cognizable damages for two reasons. First, 3M argues that damages to the Plan must be measured by reference to the entire portfolio. Given that the Plan undisputedly prospered on a portfolio-wide basis, met its benchmarks, and outperformed the vast majority of its peers throughout the period of the Granite investment, the Plan has not been damaged. Second, 3M contends that the Plan has not been damaged because it voluntarily contributed over $500 million to the Plan between 1990 and 1996, the Plan has never missed a payment to its beneficiaries, and the Plan had a surplus in excess of $300 million at the time Granite collapsed which has now grown to just under $500 million. The Class responds that it does not matter whether the Plan's overall performance has been positive; if 3M breached its duties as to the Granite investment, the Plan is entitled to the loss in asset value attributable to that breach.

The Court rejects 3M's first argument. 3M is obligated to make good losses to the Plan resulting from its breach. *See* § 1109(a). That the Plan's portfolio as a whole profited during the period of the Granite investment does not immunize 3M from liability for its alleged breach of fiduciary

duty. As the Eighth Circuit indicated in adopting the Second Circuit's loss analysis in *Donovan v. Bierwirth*, 754 F.2d 1049, 1057 (2nd Cir. 1985), the loss is determined "by comparing the [plan's] actual profit to potential profit that could have been realized in the absence of breach." *Roth v. Sawyer-Cleator Lumber Co.*, 61 F.3d 599, 604 (8th Cir. 1995).

Moreover, this is not a circumstance in which gains in other parts of the portfolio should be offset against losses resulting from the challenged investment. As discussed in the previous section, the Class is not attempting to criticize 3M's investment strategy and then isolate a single unsuccessful investment to calculate the loss. Rather, the Class claims that no prudent fiduciary in 3M's position would have made and maintained the Granite investment, even if 3M's strategy and objectives were otherwise sound.[19] For this reason, the Court finds inapposite the Seventh Circuit's theoretical discussion in *Leigh v. Engle*, 858 F.2d 361, 368 (7th Cir. 1988), of the logic of looking at the performance of the entire portfolio. Thus, assuming *arguendo* that 3M breached its duty by investing in Granite, the loss is the difference between the Plan's actual profits and the profits it would have achieved had there been no breach.

3M's second argument has more merit, however. While the Granite investment caused the Plan's portfolio to suffer a setback, 3M has made far more significant, allegedly voluntary contributions to the Plan. In addition, at least

19. In other words, even assuming that it was prudent for 3M to invest the $20 million in a relatively risky investment, had its personnel undertaken proper investigative and monitoring efforts, they would have uncovered information which would have led a prudent fiduciary to avoid Granite.

according to 3M, the Plan has a substantial surplus. The Court believes, in the unique circumstances of this case, that if 3M indeed has contributed amounts sufficient to put the Plan's portfolio in a surplus position, the Granite investment has not caused the Class or the Plan any cognizable harm.

The Supreme Court's opinion in *Hughes Aircraft Co. v. Jacobson*, 119 S. Ct. 755 (1999), is particularly instructive here.[20] In *Hughes Aircraft*, a group of retired beneficiaries brought suit, claiming that Hughes, the employer and plan administrator, had violated ERISA by amending the Plan to provide for early retirement and noncontributory benefits. *See id.* at 759-60. The Court rejected plaintiffs' claims, concluding in part that because Hughes only had used surplus funds to fund the newly created benefit programs, plaintiffs were never deprived of their interest in their accrued benefits. *See id.* at 762.

The plan at issue in *Hughes Aircraft*, like the 3M Plan, is a "defined benefit plan" under ERISA. In distinguishing a defined benefit plan from a defined contribution plan, the Supreme Court summarized the critical attributes of the former as follows:

> A defined benefit plan . . . consists of a general pool of assets rather than individual dedicated accounts. Such a plan, "as its name implies, is one where the employee, upon

20. The Supreme Court decided *Hughes Aircraft* after oral argument on this matter. 3M notified the Court of the *Hughes Aircraft* decision by letter, and the Class responded to the decision in the same manner.

retirement, is entitled to a fixed periodic payment." The asset pool may be funded by employer or employee contributions, or a combination of both. But the employer typically bears the entire investment risk and — short of the consequences of plan termination — must cover any underfunding as the result of a shortfall that may occur from the plan's investments. Conversely, *if the defined benefit plan is overfunded, the employer may reduce or suspend his contributions.*

The structure of a defined benefit plan reflects the risk borne by the employer. Given the employer's obligation to make up any shortfall, no plan member has a claim to any particular asset that composes a part of the plan's general asset pool. Instead, members have a right to a certain defined level of benefits, known as "accrued benefits." That term, for purposes of a defined benefit plan, is defined as "the individual's accrued benefit determined under the plan [and ordinarily is] expressed in the form of an annual benefit commencing at normal retirement age." In order to prevent a subsequent downward departure in benefits below a member's contribution amount, a defined benefit plan participant has a nonforfeitable right to the greater of (1) the benefits provided under the plan or (2) the amount derived from the employee's accumulated contributions, determined using an interest rate fixed by statute. Given this accumulated

> contribution floor, plan members generally have a nonforfeitable right only to their "accrued benefit," so that a plan's actual investment experience does not affect their statutory requirement. *Since a decline in the value of a plan's assets does not alter accrued benefits, members similarly have no entitlement to share in a plan's surplus* — even if it is partially attributable to the investment growth of their contributions.

Id. at 761-62 (citations omitted and emphasis added). The Supreme Court therefore concluded that because Hughes did not deprive participants of their accrued benefits when it used the surplus to fund new benefit programs, the participants suffered no detriment. *See id.* at 762.

This Court believes the analysis in *Hughes Aircraft* is applicable here. It is true, as the Class points out, that the Supreme Court provided the above analysis in the context of addressing the plaintiffs' vested-benefits and anti-inurement claims while separately rejecting plaintiffs' breach of fiduciary duty claims on other grounds. *See id.* at 762-64. Yet nowhere in its decision did the Court state that its conclusions regarding surpluses in defined benefit plans do not implicate fiduciary duty claims relating to an employer's management of plan assets.[21]

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21. The theory the Court rejected in *Hughes Aircraft* posited that an employer could not, consistent with its fiduciary obligations, amend the plan to the alleged detriment of the existing participants (Cont'd)

Appendix C

It is worth noting that in *Bennett v. Conrail Matched Savings Administrative Committee*, No. 97-1916, 1999 WL 86842, at *4-6 (3rd Cir. Feb. 1999), the Third Circuit held, relying in part on *Hughes Aircraft*, that participants of a defined contribution plan are not entitled to surplus assets at termination or partial-termination. In that case, the court specifically found that plan participants lacked standing to bring *breach of fiduciary duty* claims because they were not entitled to any surplus. *See id.* at *6. Arguably, *Bennett* is distinguishable from this case because it involved a surplus existing when the plan was terminated. Indeed, the Class argues that where, as here, a supposed surplus is a transient phenomenon that is subject to future change, it should not operate to preclude recovery for investment losses resulting from the breach of fiduciary duties.[22] However, the circumstances and reasoning in *Hughes Aircraft* demonstrate that the potential for future fluctuations in plan assets does not affect the analysis. *Hughes Aircraft* involved an amendment of the Plan, not a termination. In that context, the Court simply stated that participants have no entitlement to the *existing* surplus, without expressing

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(Cont'd)
and to the alleged benefit of the employer. *See id.* at 760, 763. The Court rejected these claims, finding that an employer does not act in a fiduciary capacity when it amends a plan, and that the amendments did not constitute a sham transaction. *See id.* at 763-64. The Court never indicated that fiduciary claims relating to investment of plan assets are exempted from its analysis of the nature of defined benefit plans.

22. Also, the Class points out that the calculation of what constitutes a surplus at the time of termination is different than at other times and is based on very conservative assumptions.

concern for potential fluctuations in plan assets in the future. *See* 119 S. Ct. at 761-62. Again, this point is most clearly illustrated by the fact that, despite future uncertainties, employers may reduce or suspend their contributions as long as accrued benefits presently are funded. *See id.*

The Supreme Court's reasoning governs the Class's breach of fiduciary duty claim. Under § 1109(a), a fiduciary is responsible for making good to the plan "any losses to the plan." Yet if the Plan is overfunded as a result of charitable growth in the portfolio investments and 3M's contributions, 3M can cease its contributions until the surplus is gone. *See id.* at 761. The existence of a surplus therefore is purely gratuitous on 3M's part. Because the Class has no entitlement to any surplus, it obviously has no claim against 3M for an additional surplus.[23] Thus, if there is a surplus due to 3M's contributions, the Granite investment caused no "losses to the plan."[24]

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23. The Court notes that while the *Hughes Aircraft* analysis controls in this case, its applicability to other contexts is limited. For example, nothing in *Hughes Aircraft* precludes recovery of defined benefit plan assets or profits that have been wrongfully retained by others. Also, because the analysis in *Hughes Aircraft* depends on the relationship between participants in a defined benefit plan and the employer-sponsor that makes contributions to the plan, it appears to apply only to fiduciaries that are employers.

24. Likewise, if there is no surplus, but the underfunding of the Plan is less than the amount of the loss associated with the Granite investment, then the Class's damages are limited to the amount of underfunding.

Nevertheless, the Court cannot determine, from the evidence and arguments the parties have presented, whether the Plan indeed has a surplus as calculated using the methodology mandated by ERISA and *Hughes Aircraft*. Delahanty, 3M's expert, opined that the Plan had a surplus in excess of $300 million at the time the Granite loss was realized, and that surplus now grown to just under $500 million. However, these amounts are premised on Delahanty's own actuarial assumptions which, although perhaps realistic in economic terms, do not appear to be tied to the dictates of ERISA. Likewise, while it is undisputed that 3M has "voluntarily" contributed more to the Plan than required under the Internal Revenue Code since the Granite loss, 3M has not shown whether or not these contributions have created a surplus as defined by ERISA. If these contributions have not resulted in a fully funded position, then 3M has not recouped fully the cognizable loss to the Plan. Correspondingly, although Class counsel challenged Delahanty's calculations based on actuarial assumptions contained OBRA and the RPA, the Class has not offered affirmative evidence that the Plan indeed is underfunded.

The Class has provided uncontroverted evidence that the Granite investment caused at least a potential loss to the Plan of as much as $80 million. Whether the Plan has a surplus remains an open question. Given this record, the Court finds that fact disputes preclude summary judgment at this point. However, if either party believes that the issue of whether the Plan has a surplus, as defined under ERISA and *Hughes Aircraft*, is capable of resolution on a motion for summary judgment, it may move the Court within ten (10) days of this

Order for leave to file such a motion. Within the same time period, either party may move the Court for limited discovery on this matter.[25]

III. Causation

3M argues that, even if the Class is able to establish a breach of fiduciary duty and a loss, there is insufficient evidence in the record to create a genuine fact dispute as to whether the breach caused the loss. Specifically, it asserts the alleged breach did not cause the loss because reasonable fiduciaries who had complied with the standard of care could have disagreed about whether to make the investment. In support of this contention, 3M points out that over ninety other sophisticated investors chose to invest in Granite and that three of its experts have opined that reasonable minds could differ as to whether the Granite investment was reasonably prudent.

The Court finds that fact disputes preclude summary judgment on this issue. As indicated previously, Eighth Circuit law requires that 3M bear the burden of proof on causation once the Class has established a prima facie case of breach and loss. *See, e.g., Roth*, 16 F.3d at 917 (quoting *Martin*, 965 F.2d at 671). Although 3M has presented substantial evidence in its favor, it has not established a lack of causation as a matter of law.[26]

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25. If the Court grants further discovery and leave to file another summary judgment motion, it will order an accelerated discovery and briefing schedule and will restrict the length of memoranda.

26. Although it need not reach the issue, the Court notes that even if 3M did not bear the burden on this issue, fact disputes would preclude summary judgment.

Appendix C

The Court agrees with 3M that there is no causal link between an alleged breach of fiduciary duty and an investment loss if a hypothetically prudent fiduciary would have made the same investment. *Roth*, 16 F.3d at 919 ("Even if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway."). In addition, if "reasonable minds" of fiduciaries confronting the same circumstances can differ on the prudence of the investment, 3M is entitled to judgment in its favor. *See, e.g., In re Unisys Sav. Plan Litig.*, No. 91-3067, 1997 WL 732473, at *25 (E.D. Pa. Nov. 24, 1997); *see also Steward v. National Shopmen Pension Fund*, 795 F.2d 1079, 1083 (D.C. Cir. 1986) ("Choices between reasonable alternatives . . . are for the trustees, not the counts.").

However, the Court rejects 3M's suggestion that simply because ninety other sophisticated investors chose to invest in Granite, a prudent fiduciary in 3M's position would have made the investment. This fact alone is unpersuasive since the circumstances under which these investors decided to invest in Granite is not known and because ninety is not an inherently impressive number given the universe of sophisticated and institutional investors.[27] Moreover, as set forth previously, the Court disagrees with 3M that there is no evidence that diligent investigation and monitoring would have revealed facts that would persuade a prudent investor in 3M's position to avoid investing in Granite. The Class has offered significant evidence of undiscovered, unanalyzed,

27. While the Court does not accept the Class's bold assertion that all ninety of these investors were "speculators," this number is not decisive without some additional context.

and undiscussed facts relating to the risks of the Granite strategy, the characteristics of the CMO market, the difficulties in evaluating and valuing CMOs, the nature of ACM's compensation and incentives, and Granite's leveraged and hedged position. Although 3M suggests that the Class's claim is based on "hindsight evidence," the Class has provided evidence that much of this information could have been gleaned from sources available before and during the Granite investment.[28]

3M's offers facially stronger evidence of the lack of causation in the form of opinions of three investment experts, who contend that they would have endorsed 3M's decision to invest in Granite at the time. The Class does not offer directly contrary expert opinions, but suggests that these three hindsight opinions deserve little weight because none of these retained experts recommended Granite to their clients at the time. In addition, the Class again points to the significant expert and other evidence in the record of various "red flags" regarding the investment that 3M would have discovered with greater diligence. Although these opinions may persuade a fact finder, given that they are not definitively impartial, and given all of the Class's evidence of available information

28. Information regarding Askin's fraudulent asset valuations in 1994, the alleged collusion between dealers to cripple Askin, and the allegedly unprecedented rise in interest rates, obviously was not available to 3M prior to or during the time of the investment. To the extent portions of the Granite loss are attributable to reasonably unforeseeable events, 3M obviously cannot be held accountable for such losses. However, there is no evidence before the Court that establishes whether certain events — such as the rise in interest rates — indeed were unforeseeable or the percentage of the loss, if any, that was attributable to such occurrences.

that would have raised serious concerns about the risks and appropriateness of the Granite investment, the Court cannot conclude that these opinions establish as a matter of law that reasonable minds could differ as to the prudence of the investment. 3M's motion for summary judgment therefore must be denied.

ORDER

Based on the foregoing, and all of the records, files and proceedings herein, **IT IS HEREBY ORDERED:**

1. Plaintiffs' motion for partial summary judgment [Docket No. 63] is **DENIED.**

2. Defendant's cross-motion to dismiss, or in the alternative for summary judgment on plaintiff's prohibited transaction claim [Docket No. 78] is **GRANTED,** and this claim is **DISMISSED WITH PREJUDICE.**

3. Defendant's motion for summary judgment [Docket No. 70] is **DENIED.**

4. Either party may, within ten (10) days of the date of this Order, move the Court for leave to file a motion for summary judgment on the issue of whether the Plan has a surplus. Either party may also, within ten (10) days of this Order, move the Court for leave to conduct limited discovery on this issue.

Appendix C

Dated: March 31, 1999.

s/ John R. Tunheim

John R. Tunheim
United States District Judge

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT DENYING PETITION FOR REHEARING AND FOR REHEARING EN BANC DATED JULY 11, 2002

No. 00-2214/01-1213

Carol Harley; et al.,

Appellants,

v.

Minnesota Mining and Manufacturing Company,

Appellee.

Order Denying Petition for Rehearing and for Rehearing En Banc

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge McMillian, Judge Bye and Judge Riley would grant the petition for rehearing en banc.

Judge Morris S. Arnold and Judge Melloy took no part in the decision in this matter.

(5128-010199)

July 11, 2002

Order Entered at the Direction of the Court:

s/ Michael E. Gans
Clerk, U.S. Court of Appeals, Eighth Circuit

APPENDIX E — STATUTORY PROVISIONS INVOLVED

ERISA § 406, 29 U.S.C. § 1106. Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect —

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 1107(a) of this title.

(b) Transactions between plan and fiduciary

A fiduciary with respect to a plan shall not —

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

* * *

Appendix E

ERISA § 408, 29 U.S.C. § 1108. Exemptions from prohibited transactions

* * *

(b) Enumeration of transactions exempted from section 1106 prohibitions

The prohibitions provided in section 1106 of this title shall not apply to any of the following transactions:

(1) Any loans made by the plan to parties in interest who are participants or beneficiaries of the plan if such loans (A) are available to all such participants and beneficiaries on a reasonably equivalent basis, (B) are not made available to highly compensated employees (within the meaning of section 414(q) of Title 26) in an amount greater than the amount made available to other employees, (C) are made in accordance with specific provisions regarding such loans set forth in the plan, (D) bear a reasonable rate of interest, and (E) are adequately secured. A loan made by a plan shall not fail to meet the requirements of the preceding sentence by reason of a loan repayment suspension described under section 414(u)(4) of Title 26.

(2) Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.

(3) A loan to an employee stock ownership plan (as defined in section 1107(d)(6) of this title), if —

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at an interest rate which is not in excess of a reasonable rate.

If the plan gives collateral to a party in interest for such loan, such collateral may consist only of qualifying employer securities (as defined in section 1107(d)(5) of this title).

(4) The investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if —

(A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliate thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment.

(5) Any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State, if the plan pays no more than adequate consideration, and if each such insurer or insurers is —

(A) the employer maintaining the plan, or

(B) a party in interest which is wholly owned (directly or indirectly) by the employer maintaining the plan, or by any person which is a party in interest with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are parties in interest (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan).

(6) The providing of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan, and if —

(A) such bank or similar financial institution has adopted adequate internal safeguards which

assure that the providing of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and adherence to such guidelines would reasonably preclude such bank or similar financial institution from providing such ancillary service (i) in an excessive or unreasonable manner, and (ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans.

Such ancillary services shall not be provided at more than reasonable compensation.

(7) The exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion.

(8) Any transaction between a plan and (i) a common or collective trust fund or pooled investment fund maintained by a party in interest which is a bank or trust company supervised by a

State or Federal agency or (ii) a pooled investment fund of an insurance company qualified to do business in a State, if —

(A) the transaction is a sale or purchase of an interest in the fund,

(B) the bank, trust company, or insurance company receives not more than reasonable compensation, and

(C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company or an affiliate thereof) who has authority to manage and control the assets of the plan.

(9) The making by a fiduciary of a distribution of the assets of the plan in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 1344 of this title (relating to allocation of assets).

(10) Any transaction required or permitted under part 1 of subtitle E of subchapter III of this chapter.

(11) A merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 1411 of this title.

(12) The sale by a plan to a party in interest on or after December 18, 1987, of any stock, if—

(A) the requirements of paragraphs (1) and (2) of subsection (e) of this section are met with respect to such stock,

(B) on the later of the date on which the stock was acquired by the plan, or January 1, 1975, such stock constituted a qualifying employer security (as defined in section 1107(d)(5) of this title as then in effect), and

(C) such stock does not constitute a qualifying employer security (as defined in section 1107(d)(5) of this title as in effect at the time of the sale).

(13) Any transfer made before January 1, 2006, of excess pension assets from a defined benefit plan to a retiree health account in a qualified transfer permitted under section 420 of Title 26 (as in effect on December 17, 1999).

(c) Fiduciary benefits and compensation not prohibited by section 1106

Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from —

(1) receiving any benefit to which he may be entitled as a participant or beneficiary in the plan,

so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; except that no person so serving who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred; or

(3) serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

* * *

ERISA § 409, 29 U.S.C. § 1109. Liability for breach of fiduciary duty.

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any

losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

* * *

ERISA § 502, 29 U.S.C. § 1132. Civil enforcement.

(a) Persons empowered to bring a civil action

A civil action may be brought —

(1) by a participant or beneficiary —

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 1025(c) of this title;

(5) except as otherwise provided in subsection (b) of this section, by the Secretary (A) to enjoin any act or practice which violates any provision of this subchapter, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this subchapter;

(6) by the Secretary to collect any civil penalty under paragraph (2), (4), (5), or (6) of subsection (c) of this section or under subsection (i) or (l) of this section;

(7) by a State to enforce compliance with a qualified medical child support order (as defined in section 1169(a)(2)(A) of this title);

(8) by the Secretary, or by an employer or other person referred to in section 1021(f)(1) of this title, (A) to enjoin any act or practice which

violates subsection (f) of section 1021 of this title, or (B) to obtain appropriate equitable relief (i) to redress such violation or (ii) to enforce such subsection; or

(9) in the event that the purchase of an insurance contract or insurance annuity in connection with termination of an individual's status as a participant covered under a pension plan with respect to all or any portion of the participant's pension benefit under such plan constitutes a violation of part 4 of this title or the terms of the plan, by the Secretary, by any individual who was a participant or beneficiary at the time of the alleged violation, or by a fiduciary, to obtain appropriate relief, including the posting of security if necessary, to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity, plus reasonable prejudgment interest on such amounts.

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